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NOMINATION OF ALAN GREENSPAN

HEARING

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE NOMINATION OF

ALAN GREENSPAN, OF NEW YORK, TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE UNEXPIRED TERM OF 14 YEARS FROM FEB. 1, 1978, VICE PAUL A. VOLCKER, RESIGNED; AND, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS FOR A TERM OF 4 YEARS, VICE PAUL A. VOLCKER, RESIGNED

JULY 21, 1987

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NOMINATION OF ALAN GREENSPAN TO BE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

TUESDAY, JULY 21, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Dodd, Dixon, Sasser, Sanford, Shelby, Graham, Garn, Heinz, D'Amato, Hecht, Gramm, Bond, Chafee, and Karnes.

Also present: Senator Moynihan.

The CHAIRMAN. Dr. Greenspan, will you rise and raise your right hand.

[Whereupon, the witness was duly sworn.]

The CHAIRMAN. We are delighted to have the two distinguished Senators from New York here to present the nominee. One of them is a very distinguished member of this committee and has served with great distinction with us and we all value his friendship as well as his ability. The other is a man we all honor as a great American. Are you the senior Senator, Pat?

Senator MOYNIHAN. I believe I am. I'm the one with the gray hair.

The CHAIRMAN. So you go right ahead.

STATEMENT OF DANIEL PATRICK MOYNIHAN, U.S. SENATOR FROM THE STATE OF NEW YORK

Senator MOYNIHAN. Mr. Chairman, you're very gracious to have Senator D'Amato and me here. And of course, he's a member of this committee. And it's a very special honor for this New Yorker to introduce to you what cannot but be the most distinguished saxophone player ever to come before the committee.

The CHAIRMAN. I always thought it was the clarinet.

Senator MOYNIHAN. I misspoke, Mr. Chairman, as they say in the hearing. [Laughter.]

Mr. Chairman, Dr. Greenspan is well and I'm sure favorably known to this committee. He has had a distinguished career as an academic, as a businessman in New York. He was an economic consultant. He is a man of world stature. He's been a student in his time and I think is in the right honorable succession to the venerable and revered Arthur Burns, whom we mourn this month.

As you know, Dr. Greenspan served for 7 years on the Council of Economic Advisers, for I believe 4 years as Chairman of the Council, faithfully carrying out the mandate of the Employment Act of 1946, being true to his profession, being loyal to his President, but having that very special capacity which is that a scholar ought to bring to his work which is the ability to tell truth to power—to speak truth to power, as the Quakers would say.

I do commend him, sir, to this honorable committee, as a man of the utmost integrity and experience and capacity for this work.

The CHAIRMAN. Thank you very much, Senator Moynihan.

Senator D'Amato.

STATEMENT OF ALFONSE M. D'AMATO, U.S. SENATOR FROM THE STATE OF NEW YORK

Senator D'AMATO. Mr. Chairman, I am really privileged to join with Senator Moynihan in introducing Dr. Greenspan as the nominee to the position of Chairman of the Board of Governors of the Federal Reserve System. We are truly fortunate to have a man of Dr. Greenspan's stature before us this morning. As Dr. Greenspan is no stranger to this committee, I will refrain from reciting the entire litany of his professional and academic accomplishments, all of which are achievements that recommend him for the position for which he is under consideration.

Most important, however, is the fact that he is a native New Yorker.

A review of Dr. Greenspan's biographical sketch reveals, Mr. Chairman, that he is a rather busy man. In addition to his position as chairman and president of Townsend and Greenspan, he currently is a member of the President's Economic Policy Advisory Board, Time Magazine's Board of Economists, Senior Adviser to the Brookings Institution, and a consultant to the Budget Office.

He currently sits on the board of seven major corporations and is a member of numerous other councils, commissions, and noncorporate boards.

Considering that he will have to sever many of these associations, it appears that Alan may be viewing the position as Chairman of the Fed as a way to reduce his tremendous workload.

Alan, I and other members of the committee want to assure you that, if anything, your workload will increase. As America's central banker, you will be the ringmaster of the three-ring economic circus which is confronting the American and world economies.

In one ring, we have an increasingly weak dollar that threatens to push the inflation rate out of control if not properly monitored.

In the center ring, we watch both U.S. and foreign economies growing at a slow rate that could easily slip into global recession that could even more easily occur should interest rates climb too high.

And in the third ring, we watch the specter of the entire world's financial system walking the unstable high wire of nonperforming Third World loans.

In short, your job will not be an easy task, since to a large extent we are entrusting you with the fate of the dollar, the course of U.S.

interest rates, and quite possibly the prosperity of the world economy.

Of all of the distinguished bankers and economists who could have been considered, I believe that you are the best successor to the Fed Chairmanship that the President could have chosen.

Further, I would suggest to those who feel that your nomination will turn the Fed into an arm of the administration, that they do not know Alan Greenspan very well. The Alan Greenspan that I know is not one who avoids the tough policy decisions for the sake of political expedience. I am confident that your tenure as Chairman will be most successful. And I say this not only because you and I have been friends for a long time, but because of your academic and professional training, you have been prepared for this position and, therefore, I quite strongly urge my colleagues on this committee and in the Senate to swiftly confirm Dr. Greenspan so he can get to work on the difficult tasks that we all know need to be done.

Thank you.

The CHAIRMAN. Thank you, Senator D'Amato.

Gentlemen, thank you very, very much.

Senator MOYNIHAN. Thank you, Mr. Chairman.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. Dr. Greenspan, I'm going to take a little longer than I've ever taken before in a preliminary statement because I think this is such an absolutely critical appointment.

You have been nominated by the President to head what is without question the most powerful and the most important independent agency in our Government. For almost all of the past 36 years the Federal Reserve Board has been headed by three remarkable chairmen—William McChesney Martin, Arthur Burns, and Paul Volcker. The economic policy of this country has gained greatly from their leadership. Their policies have contributed significantly to the economic growth of our country.

If there is one distinguishing hallmark of their service as Chairmen of the Fed it was their consistent independence. They were independent of the President and they were independent of the Congress.

Chairman Martin never hesitated to say no to President Truman, to President Eisenhower, to President Kennedy or President Johnson. I can recall how furious President Johnson could become when he was frustrated, but Martin didn't hesitate to say no to him anyway. Chairman Burns often ignored the pleadings of President Nixon and President Ford. And Chairman Volcker was a sore point for Presidents Carter and Reagan.

Each of these men also resisted the pleading of Congress for a more expansive, stimulative monetary policy. If Congress pays any attention at all to monetary policy, it is to call for a more expansive policy. If interest rates are high, it's the Fed's fault. If they are low, the administration and Congress fall all over themselves claiming credit, especially when an election approaches.

It's hard for any chairman to say no to this plea for more monetary goodies. It is especially hard because the Chairman has only one vote on this seven-member board. He has only one vote on the twelve-person Open Market Committee that determines the buying and selling of Government securities that expands, contracts, or keeps stable the country's monetary supply.

Now you, Dr. Greenspan, face a tougher problem than any of your three great predecessors. Each of them chaired a board that had been appointed by a variety of different Presidents over a period of years. The Congress wisely created the 14-year term for Federal Reserve Governors with precisely this independence in mind. The 14-year term gave the board enough political diversity and enough ideological diversity so that a strong chairman could find the support among fellow governors to resist the pleading of the President, even a President who had appointed him because the same President would rarely have appointed more than two or three of the governors.

None of this will be true in your case. You will accede to the chairmanship of a board that has been stripped of the independence provided by the 14-year term. Think of it. Who is the senior member of the board of governors of the Federal Reserve Board today? The answer is Martha Seger. When was she appointed? Four years ago, in 1983. The fact is that President Reagan has appointed every one of the present members of the board, all of them.

We are now less than 17 months away from the next election. It will be a congressional election. It will also be a Presidential election. All incumbent Members of the Congress, Democratic as well as Republican, will be pushing you in one direction—toward easy money, expansive policy that will keep the recovery going, preferably an expansive trip right up to next November.

The President and his economic specialists will be pushing in exactly the same direction. Now this isn't patty-cake. The Presidency of the United States is at stake. Now, for the first time in this Senator's long memory, one President will have appointed every single member of the Federal Reserve Board, all seven members. They and you, too, will feel an understandable instinct to be helpful to your benefactor, the President, and his party.

From the time you take over this office you will be entreated to expand the Nation's money supply. You will be tempted to take the chance that too much money chasing too few goods won't give us another runaway inflation of the kind our country suffered through 10 years ago.

Are you the man who can say no to the administration and to the Congress? You have had some impressive years as Chairman of the Council of Economic Advisers. You were the President's trusted adviser, his counselor and economic supporter. You also impressed the Congress, including this Senator, who voted against your appointment to chair the CEA. I was wrong in that vote. You were a get along, go along, comfortable, and increasingly popular chairman.

Now you may have to reverse that congenial, cooperative spirit. You have to find it in you to deny the President the easy money policy he and his party want. You have to say nix to the Congress, too. As usual, the only voice you will hear from the Congress will be a steady chant to ease up on the money supply.

With that board all appointed by the same President, all appointed with the expectation it would give the administration an easy money policy it craves, you're going to have your hands full bringing it along for a strong, steady, anti-inflationary policy if you do want to keep your President from the monetary feast he wants.

Dr. Greenspan, as Chairman of the Federal Reserve Board, you are not only the high priest of monetary policy. You are the country's leading bank regulator. The Fed, as we know, regulates a large number of State member banks. It also regulates the bank holding companies that control an increasing proportion of all the commercial banking in our country.

You take over this position at a time when there's a headlong drive toward increasing bank concentration. Late last year, the first and second largest banks in Texas, banks that have been red hot competitors, merged. A couple weeks ago, the second and third largest banks in Wisconsin, also interest rate competitors, announced their intention to merge and form a bank that will be far larger than its nearest competition in Milwaukee and throughout Wisconsin.

As Chairman of the Federal Reserve Board, you and your agency play the key role in approval or disapproval of these massive bank mergers. Last year, most of the ten biggest mergers in the history of banking in this country took place, in one year. The administration in the person of Under Secretary of the Treasury George Gould has said that he agrees with this merger mania. He's been reported by the New York Times to favor the creation of five to ten megabanks. You will have the prime voice in determining whether this kind of concentration that is already underway should be encouraged.

You come to this critical position as the director of both J.P. Morgan and Company and its principal bank, Morgan Guaranty. You've been reported to have announced that you will recuse yourself from all matters directly affecting Morgan. But, of course, you will necessarily take part in matters that would have a general indirect but major effect on Morgan and its opportunities.

You also come to this position as a paid advocate—that's the term they use—for Sears, Roebuck. Sears, as you know, owns the most rapidly growing nonbank. Any position you take on nonbanks will affect the interest and opportunity of your former client.

Now there's a saving grace in all this. Both as a highly successful private economist and economic consultant and as a Government economist and economic leader, you have consistently shown a sense of discipline. We, of course, know of your early identification with the extreme individualism of Ayn Rand. As I've said, we are familiar with your service to some of the biggest, most powerful corporations in the country.

But in all your activity, you have been sensitive to what the hard data tells you. You have expressed your concern about the economy's inflationary tendencies. You recognized the enormous pressure, the inevitability of pressure for inflation.

I would feel much better about this appointment if there was somewhere in your record an indication of your awareness of the dangers to our economy of excessive financial concentration. Maybe you can reassure us that you understand that banking should be separated from commerce and the unique multiplicity of banking in this country is an immense source of strength for our small businesses and that you can't have competition without having a large number of banks, as many banks as possible competing in every banking market. Do you have a conviction that regulators, no matter how able, cannot do the job as effectively and efficiently as competition? I hope as chairman, you can show us this.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Mr. Chairman, I have a prepared statement I would ask unanimous consent be placed in the record.

The CHAIRMAN. Without objection, so ordered.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Mr. Chairman and prospective Mr. Chairman, over the years that I have been here, one of the things that I have felt most strongly about and have said to every prospective member of the Federal Reserve Board is my strong belief in the independence of the Fed.

That isn't just directed at you as an incoming chairman. I was talking about the Federal Reserve Board as an institution. Because over the years I have seen many, many proposals of what the Chairman speaks about of Congress wanting to either tighten the money supply or to loosen the money supply. As a matter of fact, when I first got here more than 12 years ago, there was a proposal before Congress to legislate the monetary targets for the year. I find that even more difficult to believe now than I did at the time, that we would pass a law telling the Fed what targets they should work within and make it that inflexible.

And I have certainly not always agreed with the members of the Federal Reserve Board, but I have always felt that they should be absolutely independent. Whether I agree or not was not the point. Exercise their best independent judgment.

And the reason I have felt so strongly about that is because I agree with the chairman on the inflation problem. What has not been emphasized in his statement, however, is that it is not just the Fed and how we set the "Ms" that controls inflation. Certainly, it is part of the solution to have proper monetary balance.

But I've also made the comment many, many times over the years that as long as Congress had such an irresponsible fiscal policy, that it made it very difficult for the Fed to properly balance the monetary side of it because not too many years ago most people didn't know who the Chairman of the Federal Reserve Board was. Most people in this country were not too concerned with what the Fed did because as long as Congress had a more moderate fiscal policy, monetary policy did not become nearly as important. Now we constantly find described as your position as Chairman of the Fed as the second most powerful position in the country. We've had that told to us so many times it's like the Chinese water treatment hitting you in the middle of the head.

I think it's unfortunate that we have elevated the position to that level of at least perception of importance and I've heard

Chairman Volcker sit there for years and testify about the problems of inflation. But the point I'm trying to make is, no matter what you do, no matter how independent you are, and exercise your judgment and do the job just right, we are still going to have inflationary problems in this country until Congress does something about the fiscal side of it.

And we tend to give speeches here in this body and in the House of Representatives as if somehow nothing we do here with the fiscal policy and the budgets and $2 trillion deficits has anything to do with it; all we need is a Fed chairman who will properly manage the "Ms" and the money supply and then we'll have a stable economy that will grow and we won't have inflation and all that.

I just think it's important to emphasize that we want you to be independent, but once again to emphasize that we as Members of Congress can't hide behind the Fed Chairman and place all the blame when it goes wrong and try and take all the credit when it goes right, because we have done an incredibly miserable job of managing the fiscal policy of this country through several administrations and under both Democratic and Republican control of the U.S. Senate.

So we've got a lot of work to do, too, and I would hope that we would do that so that the Fed Chairman is not the second most important job in the country, but Congress would recognize our fiscal responsibilities. I think the President has made an excellent choice. I certainly admire you for the work you have done in the past and would hope that we could expedite your confirmation.

It's my understanding that Chairman Volcker's term expires on August 6, and certainly before we adjourn for August recess I would hope that your confirmation would have taken place so that you can be on the job when Chairman Volcker leaves.

Thank you, Mr. Chairman.

[The complete prepared statement of Senator Garn follows:]

STATEMENT OF SENATOR GARN
JULY 21, 1987

THIS MORNING WE MEET TO CONSIDER THE PRESIDENT'S NOMINATION OF ALAN GREENSPAN TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, A JOB THAT HAS BEEN DESCRIBED AS THE SECOND MOST IMPORTANT IN WASHINGTON.

PAUL VOLCKER'S TERM AS CHAIRMAN EXPIRES ON AUGUST 6. HE HAS DESCRIBED ALAN GREENSPAN AS AN "OUTSTANDING CHOICE" TO BE THE NEW CHAIRMAN OF THE FED. ASSUMING THAT THESE HEARINGS CONFIRM CHAIRMAN VOLCKER'S ASSESSMENT, IT IS IMPORTANT THAT WE MOVE EXPEDITIOUSLY TO COMPLETE ACTION ON THE NOMINATION BEFORE CONGRESS LEAVES FOR ITS AUGUST RECESS.

I AM PLEASED TO NOTE THAT THE FINANCIAL MARKETS SEEM TO SHARE CHAIRMAN VOLCKER'S ASSESSMENT OF THE EXCELLENT CHOICE THE PRESIDENT HAS MADE. ON THE DAY BEFORE ALAN GREENSPAN WAS NOMIMATED, THE DOW JONES AVERAGE CLOSED AT 2278. LAST WEEK THE DOW CLOSED ABOVE 2500 FOR THE FIRST TIME IN HISTORY.

WHILE ALAN GREENSPAN MAY NOT DESERVE ALL THE CREDIT FOR THAT IMPRESSIVE MARKET, IT IS CLEAR THAT THE FINANCIAL MARKETS ARE SIGNALING CONFIDENCE IN THE PROSPECTS FOR THE U.S. ECONOMY DURING A FUTURE WITH DR. GREENSPAN AT THE FED'S HELM.

SOME HAVE CHARGED THAT DR. GREENSPAN COULD THREATEN A REKINDLING OF INFLATION BY ALLOWING THE MONEY SUPPLY TO GROW TOO FAST. SUCH CONCERN OVER THE RATE OF MONEY GROWTH, HOWEVER, IS MORE RELEVANT TO OUR IMMEDIATE PAST THAN TO THE FUTURE.

THE PAST TWO YEARS HAVE SEEN SOME OF THE FASTEST MONEY GROWTH IN AMERICAN HISTORY. I AM MORE CONCERNED THAT PRESSURE ON THE NEW FEDERAL RESERVE BOARD TO ESTABLISH ITS INFLATION-FIGHTING CREDENTIALS COULD LEAD TO TOO-ABRUPT A SLOWING OF MONEY GROWTH. AS THE EXPERIENCE OF 1980-81 SHOWED US, TOO SHARP A SLOWING IN MONEY GROWTH CAN CAUSE A RECESSION.

TAKING OVER THE CHAIRMANSHIP OF THE FED AT THE PRESENT TIME HAS BOTH PLUSES AND MINUSES. ON THE PLUS SIDE, THE ECONOMY IS PERFORMING QUITE WELL: WITHIN THE NEXT FEW MONTHS, THIS ECONOMIC EXPANSION WILL BECOME THE LONGEST PEACETIME PERIOD OF RECESSION-FREE GROWTH IN U.S. HISTORY, THE UNEMPLOYMENT RATE HAS DROPPED TO 6.3 PERCENT AND INFLATION REMAINS UNDER CONTROL.

THE NEGATIVE SIDE OF ASSUMING THE FED CHAIRMANSHIP TODAY IS THAT IT WILL BE DIFFICULT FOR MR. GREENSPAN TO LEAVE OFFICE WITH THE ECONOMY IN BETTER SHAPE THAN HE FOUND IT.

THE SITUATION ON THE LEGISLATIVE FRONT, HOWEVER, IS NOT AS GOOD AS THE SITUATION ON THE ECONOMIC FRONT. THE SENATE AND THE HOUSE HAVE JUST FINISHED A CONFERENCE THAT PRODUCED WHAT THE NEW YORK TIMES' LEAD EDITORIAL LAST WEEK DESCRIBED AS "A BANKING BILL WORSE THAN NO BILL."

THE NEW YORK TIMES JOINED THE WASHINGTON POST IN URGING THE PRESIDENT TO VETO THIS ANTI-CONSUMER, ANTI-COMPETITIVE LEGISLATION. WHILE I AM NOT ACCUSTOMED TO BEING IN TOTAL AGREEMENT WITH THE NEW YORK TIMES AND THE WASHINGTON POST, I FIND THEM DEAD RIGHT ABOUT THIS DREADFUL BILL.

I DO HOPE THAT MR. GREENSPAN WILL BE ABLE TO HELP CONGRESS CRAFT BETTER FINANCIAL-STRUCTURE LEGISLATION IN THE FUTURE.

The CHAIRMAN. Senator Riegle.

OPENING STATEMENT OF SENATOR RIEGLE

Senator RIEGLE. Thank you, Mr. Chairman.

Dr. Greenspan, let me congratulate you on your nomination. We've known each other for many years through a number of different situations and I have long admired and appreciated your commitment to public service and to public issues. I think clearly you bring the qualifications needed to tackle this job.

As others have said, I think this job at this time is as demanding an assignment as we have in the Federal system. I think Senator Proxmire points out the fact that we have a Board that is relatively new in terms of length of service and in some respects complicates the challenge that we face. I think experience is worth something and particularly on the Federal Reserve Board and by the very nature of the length of the time that our Board members have served you come in with a Board that lacks the same length of experience that we have seen on other occasions and I find that unsettling. I do for the reason of the fact that I think we face extraordinary financial challenges today. You and I have had some occasion to talk about that before today.

All the data that we see indicates that we're living on an international credit card these days. We are adding new international debt at the rate of $1 billion every 2½ days and the debt accumulation of both borrowing from abroad and borrowing at home, the leveraging that we see by the Government, by the private sector, by individuals, seem to me to be building up at an extraordinary rate and the more that happens, particularly with the Federal Government deficit being sort of a centerpiece in that, along with the trade deficit, the maneuvering room for the Fed is less and less, and it's very difficult to take and expect monetary policy by itself to manage to settle out all the problems when we've got these other issues that in many respects are, I think, out of control or certainly building up at an alarming rate.

So that to me is an enormous challenge and I appreciate the fact that you are willing to take it on. The chairman has mentioned the importance of independence in the Fed and you clearly understand that, as well as the policy predisposition that you bring on the major issues.

Certainly on financial deregulation, I think if we're going to do it, we ought to do it by law with the Congress changing the law and the President signing it, and not by administrative fiat or decision. I think these are profound issues, they are important issues, and however we settle them we ought to do it with changes in law rather than just administrative judgments by unelected officials. So I would hope that we would find that to be the case.

I would hope you would talk today about as you have a chance to present your own thinking is your sense for the amount of maneuvering room that the Fed has today and using monetary policy is one of the aspects of our financial strategy mixture of tools. How much latitude does the Fed have today, given the other problems that I've mentioned—the Federal deficit, the trade deficit, the debt accumulation in many directions—and what is it realistic for us to expect? What can the Fed do even if it does a perfect job with its decisionmaking? How large a role can it play in a sense acting in a fashion to try to help us manage our way through these difficulties?

I hope you will talk about that today.

The CHAIRMAN. Thank you, Senator Riegle.

Senator D'Amato.

Senator D'AMATO. Mr. Chairman, I pass.

The CHAIRMAN. Senator Dodd.

Senator DODD. Just to congratulate, Mr. Chairman, our nominee and wish him well. And I will reserve any comments until the question period.

The CHAIRMAN. Senator Hecht.

OPENING REMARKS OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman.

I would like to join in welcoming Mr. Greenspan here today and I look forward to hearing your testimony. I'm going to put into the record a prepared statement. It seems that all that I have in my prepared statement has already been addressed today.

Let me just make a couple points to you. As Senator Garn said, the second most powerful position in America and I don't mind repeating it because it is definitely, and Congress today is in an isolation mood. There's also an isolation mood in this committee. We are not an island. We are part of the total global financial picture and now we are going to attempt to see if we can remain the global financial giant that we are. Americans do not like to be No. 2. We want to be No. 1. And that responsibility is going to be on your shoulders. Good luck.

[The complete prepared statement of Senator Hecht follows:]

STATEMENT OF SENATOR HECHT

Thank you Mr. Chairman. I would like to join in welcoming Mr. Greenspan here today, and I look forward to hearing your testimony.

Obviously, our economy has some problems which need to be addressed. Foremost in my mind are the Federal Budget deficit and our alarmingly high trade deficit. However, when we look at the total picture, I feel we are in relatively good shape. Our economy is void of the high interests rates and inflation of the 70's that suffocated it's expansion. We have all worked very hard to bring inflation under control and interest rates to a reasonable level. I am hopeful that under Mr. Greenspan's guidance, that these policies will continue.

Thank you Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hecht.

Senator Dixon.

OPENING REMARKS OF SENATOR DIXON

Senator DIXON. Mr. Chairman, I just want to say that I share the view of many committee members who have already expressed their warm regard for Paul Volcker and the job he has done as Chairman of the Fed. I recall in the early 1980's when every populist of every political persuasion in the country was demanding changes in policy, Paul Volcker has the courage to stay the course and I just want to say that I think the President has made an excellent selection in Alan Greenspan. I think he's that kind of a man and I'm delighted to indicate to him that I am going to support the confirmation of Alan Greenspan as the new Chairman of the Fed.

[The complete prepared statement of Senator Dixon follows:]

PREPARED STATEMENT OF SENATOR ALAN DIXON

Mr. Chairman, I am pleased to be here this morning as the committee considers the nomination of Alan Greenspan to be Chairman of the Board of Governors of the Federal Reserve System. I look forward to hearing from Mr. Greenspan this morning. However, I would like to say at the outset that I support his nomination. I think he will make a fine Chairman.

Since I first came to the Senate in 1981, I have listened to Paul Volcker, the retiring Federal Reserve Chairman, give this committee the benefit of his candid views on a variety of issues. I have watched him make the tough decisions on monetary policy and other issues. Chairman Volcker is a tough act to follow, but given Mr. Greenspan's towering reputation, I expect him to be just as strong-minded and just as independent as Paul Volcker has been. Mr. Greenspan, in the past, has always called them as he saw them; I look forward to seeing more of the same in his new position.

This is a time of real challenge for the Federal Reserve Board and the U.S. economy. I sometimes wonder why anyone would want the job of Fed Chairman. After all, when the economy goes well, Congress and the President take the credit. When the economy performs poorly, one of the first to be blamed—usually unfairly—is the Fed.

I am pleased, therefore, that the President has put forward such an excellent nominee, and I think that Mr. Greenspan is doing the Nation a real service. I look forward to hearing his testimony this morning and to working with him in the future.

The **CHAIRMAN**. Senator Karnes.

OPENING REMARKS OF SENATOR KARNES

Senator **KARNES**. Thank you, Mr. Chairman. I, too, welcome you, Dr. Greenspan, before our committee and applaud you for your willingness to once again reenter public service.

My concerns will be more fully expressed during the question period but I would like to have you make a note to consider addressing if you would at some point in time some of the concerns about the Farm Credit System and the agricultural interests that are so important to my State of Nebraska.

I applaud you once again for your willingness to assume this awesome task of leading the Fed. I wish you the best and encourage you to work with the committee as you have in the past and I ask you only in your remarks to comment briefly if you would on the concerns that you have with agriculture.

Thank you very much.

[The complete prepared statement of Senator Karnes follows:]

STATEMENT OF SENATOR DAVID K. KARNES

Thank you, Mr. Chairman. I am very pleased to participate in the confirmation of such a highly respected, economist as Dr. Greenspan. The performance of your predecessor has been very significant in elevating the position you are seeking to one of the most powerful and influential positions in this country and in fact throughout the world. Due to the respect and confidence Chairman Volcker achieved during his tenure, your position and your actions will be subjected to tremendous scrutiny around the world. However, I am extremely confident that you can continue to lead the Federal Reserve with honor and distinction and I look forward to your work with this committee, and the Congress as a whole.

The Federal Reserve's position with regard to several of the issues this committee is currently deliberating will have a significant impact on the outcome of those discussions. Issues such as the separation of banking and commerce, the separation of commercial banking and investment banking, other expanded bank powers, FSLIC recapitalization, the proper supervisory controls on the financial industry, the possible merger of FDIC and FSLIC, insider trading, and corporate mergers and acquisitions will be greatly affected by the position the Federal Reserve takes.

I applaud the Reagan administration for the selection of Dr. Greenspan who comes to the Federal Reserve with widespread respect in national and international circles. Your conservative credentials and anti-inflationary philosophy gives me great confidence that under your leadership you can assist in avoiding the ravages of double digit inflation that wreaked havoc on the agricultural economy in Nebraska and the rest of the Midwest.

Mr. Chairman, I look forward to the remainder of this nomination hearing and to working with you, the rest of the committee, and Dr. Greenspan as we proceed to address the economic issues before us. Thank you.

The CHAIRMAN. Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Mr. Chairman, I also wish to add my congratulations to Dr. Greenspan on his nomination.

Certainly, Dr. Greenspan, you are a man of considerable knowledge and experience. No doubt you will need these skills as you confront the challenges ahead of encouraging economic expansion and in discouraging inflation, while at the same time sustaining confidence in our economy. That's a hard task.

Our Nation is confronted, as you well know, with formidable economic problems. The U.S. trade deficit is tied largely to the international exchange rates and the delicate balance between inflation control and rising monetary rates must be maintained. In addition, our Nation's budget deficit is at an all-time high. Our growing deficit remains sensitive to the policies of the Federal Reserve Board.

The fact that you so readily accepted the President's call to fill this vacancy might raise some questions about your good judgment if we didn't know better. Attempting to fill Dr. Volcker's shoes will be an extraordinary challenge. It's my sincere hope that you will rise above partisan politics, as has been mentioned here today, and avoid policies that result in short-term political gains at the expense of our long-term economic health.

Dr. Volcker was successful in subduing inflation and this restores confidence in our economy. I hope that you will continue this legacy.

One of the many problems confronting the Fed will be with the Latin loans. The economic growth of Latin America could mean much to our economy. Not only must we cope with our past debts, but new money is essential to their economic growth. How are we going to get it to them?

Another problem lies with our traditional banking institutions, as has been mentioned by the chairman. We must take the steps necessary to restore banks to a competitive position in the marketplace and yet we must ensure their stability. Our banks should return to global prominence which they have lost.

Dr. Greenspan, I look forward to your testimony here today and I certainly wish you well in your big endeavor.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Gramm.

OPENING REMARKS OF SENATOR GRAMM

Senator GRAMM. Well, Mr. Chairman, I'm sure as Dr. Greenspan listened to you and Senator Garn talk about how the Fed should be independent and how the President and the Congress is always wrong on monetary policy that he made a little note that when you call him next month to give him advice he will hang up. [Laughter.]

The CHAIRMAN. I won't call him. If I did, it would be the first time in 30 years that I've ever called a Fed chairman to give advice on anything.

Senator GRAMM. Well, I have called our current Chairman on many occasions, Dr. Greenspan. He's always taken my call and I want to make it clear I don't think there's anything wrong with the head of the Federal Reserve Board talking to Congress, listening to them. Every once in a while a few of them are right.

I don't know that I would want you to be measured by the ebb and flow of the majority, but we have had I think as far as the national interest is concerned great fortune in having William McChesney Martin and Arthur Burns and Paul Volcker, and I think your name will be etched at the bottom of that distinguished list. I hope you will serve in this office for many years and I look forward to working with you.

The CHAIRMAN. It may be even higher than the bottom. [Laughter.]

Senator Sasser.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you very much, Mr. Chairman.

I want to join my colleagues in extending my congratulations to Dr. Greenspan for being nominated to this very, very important post, a post that's important not just to those of us here in this country, although it is extraordinarily important to us, but a post that I think is of extraordinary importance worldwide. And the individual that sits with his or her hand on the throttle of the Federal Reserve I think can probably have more impact on the international economic situation than perhaps any single individual.

The nomination of Dr. Alan Greenspan, admittedly a man of very substantial qualifications indeed, both personal, academic, and from the business world, raises a number of questions, many of which I hope will be answered today by the nominee and I'm sure that they will be.

First, Mr. Chairman, as you so adroitly pointed out, how independent will Dr. Greenspan be of the economic and political agenda of the Reagan administration? Will the nominee be able to resist the pressures to pursue policies which might not be in the long-term best interests of the American people but might be in the short-term best political interests of the administration? I trust he will answer those questions today to the satisfaction of not only myself but this committee.

Second, in reading the commentators, I am concerned about some of the things that are being said and in response to those statements in the newspapers and statements by the columnists and others and statements by leaders of some of the large banks in this country, will the nominee feel compelled to prove himself as an inflation fighter and clamp down hard on monetary controls, thereby raising interest rates and sacrificing the jobs and homeownership aspirations of millions of Americans? Although I share with my colleagues their respect and admiration for Paul Volcker, let us not forget that there were other things at play that helped dampen the fires of inflation rather that just the monetary policy of the Fed in 1981 and 1982, and let us not also forget the tens of thousands of businesses that were destroyed, farms that were lost, jobs that were lost during those efforts of the Fed in 1981 and 1982 to combat inflation, utilizing what I viewed then and still consider to be an overly restrictive monetary policy.

Third, Mr. Chairman, how will the nominee address what I perceive to be the economic excesses that we are seeing today that have been compared to some of the excesses that occurred prior to the crash of 1929? For instance, the current takeover craze which it appears to me is leveraging many of our large corporations deeply into debt and also the enormous and frightening increase in corporate debt that occurs as these corporations attempt to fight off the takeovers.

Well, these are questions, Mr. Chairman, and my colleagues think are most important and I'm looking forward, as are the American people, to Dr. Greenspan's answers. This nominee has made enormous contributions to his government and to his country over a number of years of both public service and private service, so I welcome you before the committee, Dr. Greenspan, this morning and look forward with anticipation to your response to the questions. Thank you.

The CHAIRMAN. Thank you, Senator Sasser.

Senator Bond.

OPENING STATEMENT OF SENATOR BOND

Senator BOND. Thank you, Mr. Chairman.

I think that we are indeed fortunate to have before us such an outstanding individual nominated for this very important post. I have respected Dr. Greenspan since I first had an opportunity to get to know him when he was Chairman of the Council of Economic Advisers in the midseventies.

I would say I share with my colleague from Alabama the question of why anybody would want to be Fed Chairman at this time. Dr. Greenspan, you will have to contend with a fiscal policy that's out of control as a result of our inability to bring the budget deficit down, the resulting trade deficits, the lingering recessions in some parts of our country, the Third World debt crisis, a record number of bank failures, an outdated legal structure for our financial institutions.

In addition, we all know that the Federal Reserve has become a very convenient scapegoat for Congress, the White House, the press and anyone else who's dissatisfied with economic performance. There are many different qualities that we would like to see in the Federal Reserve Board Chairman, a sound grasp of economics, a willingness to take political heat from both Congress and the White

House, and the ability to make hard choices on very complex problems.

We in Congress certainly have not made the Fed Chairman's job any easier by refusing the current Chairman's plea to reduce the Federal budget deficit and get rid of the massive imbalances that that is causing in the world economy. I'm sure that you, Dr. Greenspan, are up to the task. I applaud your willingness to tackle these issues, although I do have some question about your judgment in wanting to do so.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Senator Graham.

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. Thank you, Mr. Chairman.

Dr. Greenspan, I would like to also add my voice to those who have commended you for accepting this very challenging position in these equally challenging times. I will have some questions later which will focus on what I consider to be two of the fundamental economic issues facing this Nation and the world.

The first is the issue of how do we lengthen the economic horizon in which we view consequences? It seems to me that many of our problems today fall under the umbrella of a system which evaluates results by too short a time frame and thus discourages long-term investment, both in people and in capital goods and in ideas.

Second is the integration of the United States into the world economy with particular attention to how that affects our use of market factors to make economic decisions with Government essentially in a neutral role as opposed to where the cause of the internationalization of many of our formerly domestic economic issues Government has a new role to play, and a particular dimension of that is the question of Third World debt—what should be the role of marketplace factors and commercial institutions as opposed to Government in meeting the mutual needs which this country, other creditor countries and the debtor countries in the world have in bringing that issue under control so that we can regenerate economic growth in important markets and areas which are important to America's strategic future?

Those are challenging issues. I agree that your name will be added to that list of distinguished Chairmen of the Federal Reserve System and I'm confident that the listing that was given by the other Senator Gramm was strictly chronological.

The CHAIRMAN. Thank you, Senator Graham.

We will follow a 5-minute rule in questioning until the number of members here is less than 5, and I suspect we will have several rounds before that. Senator Heinz may be a little late but he has submitted a statement for the record.

STATEMENT OF SENATOR JOHN HEINZ

Mr. Chairman, I join in welcoming Dr. Greenspan, the administration's nominee to be Chairman of the Federal Reserve Board of Governors.

In a March interview with Business Week several weeks before he was tapped for the Fed, Dr. Greenspan was asked what he thought of the Chairman's job. He responded by saying, "It's a loser."

There are many on this committee, Mr. Chairman, who can sympathize with Dr. Greenspan's sentiments. Perhaps the nomination could be put in a new category in Esquire magazine's annual Dubious Achievement Awards?

On a more serious note, I know that the committee and Dr. Greenspan recognize that the position of Chairman of the Federal Reserve Board is one of awesome responsibility. The Chairman must guide the design of monetary policy while pursuing the goal of continuing economic expansion without reigniting inflation. The Chairman must also chart the policy course for and preserve the safety and soundness of the Nation's financial system and all of its component parts.

This will not be an easy task. In fact, it is going to take a good deal of intestinal fortitude to fight the battles ahead. We have only to review the track record of the outgoing Chairman, Paul Volcker, to recognize this. Paul Volcker fought and won the battle against economic enemy number one, inflation, but at considerable cost to the Nation at the outset.

The country's economy now sits at a crucial juncture, and the next Chairman will play an important role over what direction it will take. The U.S. economy has entered its fifth year of slow, but sure, economic expansion. After rising at meteoric rates, the dollar has turned downward. While it has finally leveled off, there is good reason to worry about it taking another nose dive and reigniting inflation.

The next Chairman will also have to contend with changes in the financial services industry. In the upcoming months, this committee will begin its comprehensive review of the Nation's banking laws. The Chairman of the Fed will undoubtedly play an important role in this process.

I look forward to his testimony today.

OPENING STATEMENT OF SENATOR ALAN CRANSTON

Senator **Cranston**. I welcome Dr. Greenspan to the committee this morning to address some of the issues that will confront him as Chairman of The Federal Reserve Board.

Dr. Greenspan, you are a well-respected conservative economist. You will certainly have your job cut out for you as a successor to Paul Volcker. Anybody would.

The Federal Reserve's greatest feat under Mr. Volcker was successfully wringing inflation out of the economy, though at a great price in unemployment and economic recession. Some believe at a price that inflicted more than necessary pain upon the country. United States agriculture has not experienced such suffering since Dust Bowl times in the 1930's. American manufacturers have lost long-accustomed markets. Hundreds of banks and savings institutions have been destroyed. The Third World has been thrown into the worst debt crisis since the Great Depression. I hope that you will keep this uppermost in mind at this time of recurring fears that inflation may rebound.

As Chairman you will be blessed in having the majority of Federal Reserve Board members appointed by the same President and of the same party. Maybe we will, under your tenure, have a more coordinated Federal policy and a firmer picture of who is responsible for what is happening to the economy, the President's policies or Congress.

You are obviously qualified in your field and imminently qualified for this job, you will face tough challenges at home and from abroad. I wish you will in undertaking this task.

Thank you, Mr. Chairman.

The **Chairman**. Do you have an opening statement, Dr. Greenspan? If so, go right ahead.

STATEMENT OF ALAN GREENSPAN, NOMINATED TO BE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Dr. GREENSPAN. I have a very short statement. It's a privilege, as always, to appear before this distinguished committee today for your consideration of my appointment as Chairman of the Board of Governors of the Federal Reserve System.

I especially appreciate the expeditious fashion in which you have acted upon the President's nomination and I wish again to thank the President for the confidence he has expressed in me.

Finally, I would like to again acknowledge the extraordinary contribution that Paul Volcker has made to this country in his 8 years as Chairman of the Fed and wish him well in his next endeavor.

If confirmed, I will attempt to supply the committee with whatever analytical insights into the major problems that confront this Nation and the world that I am able to marshall and will look to this committee and the Congress in general for guidance in the difficult years ahead.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Dr. Greenspan.

Dr. Greenspan, I can assure you that as chairman of the committee I will do everything in my power to have the committee meet and act on your nomination very promptly.

Dr. GREENSPAN. Thank you, sir.

The CHAIRMAN. Now if you're confirmed, do you agree to appear before this and other committees of Congress on their request at hearings?

Dr. GREENSPAN. Yes, sir.

The CHAIRMAN. You've agreed with the Office of Government Ethics and the Federal Reserve Board to place most of your holdings into two blind trusts. Can you summarize for the committee the nature of those blind trusts?

Dr. GREENSPAN. Yes. These two trusts are reflective of the assets which I have which are split into two parts. Should the Senate confirm me and I am about to be sworn in, I will then place these assets into the two blind trusts. They will include essentially securities and other liquid assets. I divided them in two largely on the grounds that I think it's inappropriate that any one individual in a blind trust environment control one's assets. So that's the reason I have two.

The CHAIRMAN. Do you commit to the committee to enter into and abide by the blind trust arrangements you have just described?

Dr. GREENSPAN. Yes, sir.

The CHAIRMAN. In a letter to the Federal Reserve general counsel you outlined the steps you are prepared to take to recuse yourself from matters involving a potential conflict of interest.

Can you summarize for the committee the nature of that agreement?

Dr. GREENSPAN. Let me read a short statement, if I may, Mr. Chairman.

The CHAIRMAN. Yes, indeed.

Dr. GREENSPAN. And then answer questions as is necessary.

I believe I have taken all the steps necessary to resolve any conflicts of interest or appearance of conflicts of interest. The details of the measures that I have undertaken include recusals, establishment of blind trusts, and divestiture of assets.

These are contained in detail in a letter I have written to the general counsel of the Board of Governors of the Federal Reserve System which has been made available to the committee.

In taking these various measures, I have consulted very closely with the general counsel of the Federal Reserve. He has informed me that the various measures that I have taken or propose to take, including those with respect to dealing with the appearance of conflict of interest, are fully consistent with the applicable provisions of law, the Board's voluntary guide to conduct for senior Federal Reserve System officials, and with Board practice.

He has advised me that these measures are sufficient to address any conflict of interest that arises out of my past associations with Townsend-Greenspan, as well as any appearance of conflict of interest arising out of this former relationship.

Very specifically, Mr. Chairman, what I plan to do is to recuse myself from any decisions affecting directly applications or other immediate direct interests, as I explained in the letter, of Morgan Guaranty and its holding company for a period of 1 year.

With respect to matters that might involve the appearance of a conflict, I also will recuse myself from any decisions which reflect two conditions: one, they involve former clients of mine and, two, they involve matters on which I directly consulted with them.

I have discussed that at length with the Fed's general counsel and he believes that that is appropriate to the occasion.

The CHAIRMAN. Now, as you know, Sears has a nonbank bank that's been grandfathered by the provisions of S. 790, the bill that is now awaiting final Senate and House action, subject to certain restrictions administered by the Federal Reserve Board.

You performed advocacy services for Sears on the subject of financial deregulation and in particular wrote articles in support of allowing commercial and industrial firms to own banks.

I can foresee a potential conflict if the question of how to interpret the Sears nonbank bank grandfather restrictions came before the Board.

Does your recusal agreement extend to any matter involving grandfather restrictions on the nonbank banks owned by Sears?

Dr. GREENSPAN. Specifically by Sears, yes. On the general issue of nonbank banks, I wish to point out, Mr. Chairman, that the general view I have towards the issue of banking structure very significantly predates my relationship with Sears and I think that I would like to be free to discuss that issue as a general question should the issue arise. But certainly any application or any decision which specifically relates to their application in the area of nonbank banks I would feel the necessity to recuse myself.

The CHAIRMAN. Let me go back. The staff disagrees—and sometimes the staff is right, not always but sometimes—I took it in your response to me on your holding in the two blind trusts that you did specifically in the way you described it commit to the committee to enter into and abide by the blind trust arrangement you described?

Dr. GREENSPAN. Yes.

The CHAIRMAN. You did that, right?

Dr. GREENSPAN. Yes.

The CHAIRMAN. Senator Garn.

Senator GARN. Dr. Greenspan, as you well know, for several years the Congress, the administration, the Federal regulatory agencies and so on have been wrestling with the debt problems of the Third World countries.

What's your view of the Third World debt situation as of today and in light of the increased reserves that commercial banks have been setting up as a result of those loans?

Dr. GREENSPAN. Senator, the situation, while still fraught with very considerable difficulty, has improved really quite dramatically since the problem came on the international scene in 1982. I remember that there was a very grave concern expressed within the financial community at the time that that type of situation could very easily lead to not default but repudiation by a number of the major borrowers. That would have created a very significant breach in a very important structure that exists in the international financial system.

That has not happened. Not only is that not the case, but a number of very positive things have occurred concurrently. One, the commercial banks have very significantly built up their reserve balances and equity capital. In fact, the largest American banks which have very substantial exposure in Latin American debts doubled their net worth in a very few years and very sharply increased their capital-asset ratios.

There's also been significant activity within the debtor nations as well which in a way is terribly important because it reflects not only their immediate views but they're part of a growing international awareness that market solutions to financial and economic problems are the way to get out of very grave difficulties. The type of centrally planned socialist oriented types of governments, which existed in so many of the LDC's for so many years, is now becoming an increasingly less acceptable way to function.

We should recognize this because we tend to emphasize the difficulties. It's important to recognize how far we have come.

On the issue of the banks taking very significant loan provisions—they haven't written down the loans; they have just merely increased their provisions. This clearly is merely a recognition of what the markets have known all along and we have seen, as you know, Senator, a significant marking down of the stock prices of those bank holding companies with very heavy exposure in a number of these areas, and that write-down has essentially reflected what the secondary market has exhibited with respect to those various different loans.

My only concern in making this recognition is that it does not break down this extraordinary continued improvement that we've seen in the solution to these problems, which is another way of saying it is very important that the commercial banks continue as active players in the resolution of these debt problems and that the debtor nations continue to restructure their economies in such a way as to eventually enable them to restore their access to financial markets, be able to service their loans again the way they used to be able to, and in a sense make the commercial banking system not necessarily fully whole but significantly better with respect to those loans than it is today.

There are two basic problems. One, the commercial banks who have these difficult loans; and, two, the debtors who have difficult economic problems. The adjoining of those two problems, those two negatives, could very easily create a positive and I hope that we do not throw in the sponge prematurely and endeavor to take a wholly new course because the current course is slow but working.

Senator **Garn**. Well, I agree with you, Dr. Greenspan. It's still a very serious problem. I agree with you that it has improved dramatically. I can remember the most difficult task I had politically while I was chairman of this committee was increasing our quota in the International Monetary Fund. That was not very politically popular, particularly when the slogan on the other side was simply don't bail out the big banks, and you had to go into all the detailed explanation of why it was necessary to have that increase in IMF along with the conditionality that went with that increase.

I particularly remember when Argentina was talking about defaulting. Chairman Volcker called me and asked if, along with a lot of other people, we would make some telephone calls and help them understand what it meant to them and their own economy to default. It seemed like an easy way out.

I think the LDC's themselves, as you have explained, have a much better and more sophisticated understanding of what it means to them and so we passed that likelihood of default. The banks as well, are starting to recognize the realities and not hiding it under the table. They're saying we've got to take these steps and go forth.

I appreciate your assessment. I think it's an accurate one, but it's one that we again have to keep managing virtually on a day-today basis. Thank you.

Senator **Riegle**. Dr. Greenspan, we're in the middle of a vote here, so I'm going to go directly to two or three questions and then if other members have not returned I'm going to recess briefly until they do.

I want to ask you two or three very pointed questions on the independence issue because I want the questions and the answers clearly on the record today.

If financial market conditions in the middle or early fall of next year indicate that the money supply has to be tightened and you see clearly the need to do that, are you prepared to take those steps and advocate that course of action within the Fed?

Dr. **Greenspan**. Certainly. Senator, should the Senate confirm me, I will be taking an oath of office and I take that oath very seriously. It's just not credible to me that I would be advocating actions other than those which I thought were relevant to a situation. It's conceivable my advice may turn out to be wrong, my actions may turn out to be wrong, but it certainly would not be on the basis of politics rather than economics.

Senator **Riegle**. If some person in the administration, tried to muscle the decisions of the Federal Reserve System some time next year in advance of the election, what would be your response to that?

Dr. **Greenspan**. I certainly don't anticipate that happening, but were it to happen, I obviously would reject it.

Senator RIEGLE. Well, I think it's essential that that be the case and I expected that you would say that and it's my view that you would operate in that fashion. I think you have had experiences in the past of serving in administrations, a number of administrations, in different capacities. Have you ever before served in an independent agency in a capacity similar to what you will be having now here, if confirmed?

Dr. GREENSPAN. No, sir.

Senator RIEGLE. So this will be a new experience for you to be in an independent arm of the Government, so to speak?

Dr. GREENSPAN. That is correct.

Senator RIEGLE. And I take it, then, that the sense of your answer is that you see a real distinction there between that and that you need to be insulated completely from any pressure from any outside source, whether it's the Congress or the administration or anybody else?

Dr. GREENSPAN. Well, I'd like to be insulated. I'm not certain it's going to happen that way. But clearly, I think it's important for the Federal Reserve to maintain its independence. I think it's terribly critical as its institutional nature requires and I certainly will do everything that I can to see that that occurs.

Senator RIEGLE. I think Paul Volcker has taken on such enormous stature as we all know, almost of mythic size. And that's not to diminish his true size or the scale of his accomplishments. But I think it's always difficult to come after somebody who's seen as having been a giant in that position and, like it or not, you find yourself in that role.

And I think that that puts even more pressure on with respect to this issue of independence and I think nothing would destroy the effectiveness of the Fed faster, which it has to have not just domestically but I think more and more internationally, than the notion that somehow the Fed was susceptible to pressure or manipulation.

One of the reasons that I am strongly drawn to your candidacy is that I feel that when the chips are down that you will have the iron will to resist pressure from anybody in any form that you think is wrong.

Am I right in having that judgment?

Dr. GREENSPAN. I certainly hope so. I must say to you, Senator, I really don't anticipate the types of pressures you're suggesting in the form that you're suggesting. But obviously, should they occur, I would feel it absolutely essential that they be resisted.

Senator RIEGLE. Well, I hope not. We're having hearings at other locations on the Hill today and in recent weeks that indicate that all kinds of strange pressures can get loose at different times and cause people to do things that maybe they didn't think they would do. But I think the role that you will have is so vital to the economic security of the country and to our future that I think your independence has to be absolutely certifiable and it seems to me you're saying that we can have that confidence that it will be.

Dr. GREENSPAN. Yes, sir.

Senator RIEGLE. I'm going to reserve the balance of my time, Mr. Chairman, and go and vote if I may.

The CHAIRMAN. All right. Well, it's out of order now but I'm in a good spot because nobody else is here so I can go right ahead.

Dr. Greenspan, on June 6 the New York Times carried a report that Under Secretary of Treasury Gould favored the creation of five to ten giant banks that would rival in size the largest banks in Europe and Japan. The article indicated that you had signed off on this objective.

Is the New York Times article accurate? Is it a reflection of your views? Do you favor allowing large industrial and commercial firms to own banks?

Dr. GREENSPAN. That's a complex question.

The CHAIRMAN. Let me just start then, is the New York Times article an accurate reflection of your views?

Dr. GREENSPAN. Very partly, only partly. I am not in favor of the creation of superbanks. I have always been concerned that bankers too often have looked at where they stand in the list of the American Banker with respect to size and I think that that attitude really was fairly widespread in the 1960's and the 1970's and is one of the issues which I think has created some of the problems that we have had.

First of all, size per se does not strike me in the normal banking practice of having very much to say for it. All of the evidence that one can see suggests that the economies of scale and scope probably are maximized in relatively small banks in the areas of maybe $100 or $200 million in assets. There is very little evidence that competition between banks within that area or anywhere above that level gives any specific advantage to the larger institutions.

In fact, when we changed the branching laws in the State of New York a few years ago, I recall that several of the major banks in New York City had difficulty obtaining a foothold upstate. The reason this applies for basic banking practice is understandable. There are certain very important advantages which a small bank has in a community where the banker knows the people, he knows the industry, he knows the markets, and he knows the nature of the culture. It is very difficult for a larger institution, an alien institution, to move in and basically to out-compete that type of bank.

If that type of bank is to be out-competed, it is very likely to be out-competed by another relatively small bank, which in effect brings to bear some of the skills which a small banker may not have chosen to acquire when he should have.

So, in general, so far as banking practice is concerned, for the domestic economy, I see no particular advantage in being large. In fact, some of our really better banks are not all that large, and I certainly would not argue for any governmental action to create that.

Having said that, however, that does not mean that I would try in effect to inhibit those types of institutions which in the international arena believe that increased capital or scope and size are important to them. It's fairly obvious that there are certain types of international transactions which require significant capital.

Nonetheless, most types of major loans in the international arena are syndicated in any event, and that can be done by a number of different corporations.

The major point that I would make with respect to this is that even those banks which choose to get larger because they see themselves as being in a better competitive position do not threaten the basic banking structure of this country because I don't believe that they in fact can compete in the type of banking services which the relatively small bank offers. I don't believe that they can compete and, as a consequence, I don't believe that they are a threat to the basic banking structure that now exists in this country.

The CHAIRMAN. Well, your answer is very reassuring in your recognition that the small banks may be more efficient or at least as efficient as the big banks. The return on equity measure shows that the banks in this country that were the least profitable and had the lowest return on equity were the money center banks.

But there still is an enormous tendency for concentration and even in this international banking area that you speak about, the giant banks aren't doing the best. In Japan, for instance, which has the five biggest banks in the world right now—the bank that is the most aggressive and successful is the Bank of Tokyo which is 29th in size.

Dr. GREENSPAN. That's correct, Senator. I think that if you look across the spectrum of these huge banks, they are rarely the ones that are at the top. For example, even in the United States, our best banking institutions are not necessarily our largest. Our most successful clearly are not and have not been our largest in recent years.

The CHAIRMAN. Now there's another area that is absolutely critical here where the Fed has a voice. The Fed, as I understand it, has a very important part to play in whether or not mergers can take place in particular areas.

When these two Texas banks that I mentioned merged, banking was sharply diminished. Robert Straus, a very shrewd Texan who I think favored the merger, said that these banks have been knocking themselves out in competition—competing to see who could offer the lowest rate and the best terms and so forth in order to get loans in the Texas oil fields and elsewhere.

In my State of Wisconsin, when the second and third banks proposed a merger just a few days ago which will make them the biggest bank in the State and give them a $10 billion size, bigger than First Wisconsin, which is now the biggest, again hotly competing banks. Now the decision of the Fed, as I understand it, is to determine whether or not the merger will diminish competition. And even though there may be conveniences for the banks merging together and even though there may be some convenience here and there for the customers, by and large, if it diminishes competition, it's my understanding that the intent of the law is that the merger should not be approved by the Fed.

How do you feel about that?

Dr. GREENSPAN. Well, Senator, I'm not sufficiently familiar with either individual cases other than having read——

The CHAIRMAN. I'm not asking you to comment on those individual cases, but on the general problem.

Dr. GREENSPAN. I would be somewhat less concerned than you, I suspect, if for no other reason than I'm fairly well convinced that, in the event that you begin to put together banking institutions whose services deteriorate for the customer, competition will come in underneath these newer, larger institutions.

Remember that we are really not and shouldn't be interested in banking per se. We should be interested in the services that they create for the average consumer. And banks or other financial institutions which fail to meet the requirements of consumers rapidly go out of existence. I think in fact a number of the mergers that are occurring result from some deficiencies in individual institutions which feel the necessity to get together, and that may be a symptom of something else and it may require different solutions.

I would be doubtful, without looking at the evidence, that at the moment we have any really significant problems with respect to concentration in banking. We have less concentration in this country than anywhere in the world. The system obviously works. I have seen no evidence that worries me that that's about to change.

The CHAIRMAN. Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman.

Dr. Greenspan, we have seen numerous occasions in the 100th Congress where votes have taken place to waive the Gramm-Rudman budget guidelines. If Congress does not adhere to these guidelines and in effect goes on a spending spree, what do you see this doing to interest rates and inflation?

Dr. GREENSPAN. It's a difficult question to give you details on exactly how the economy will emerge, but history obviously tells us that in an environment like ours or any other economy, if budget deficits get out of control, that ultimately what happens is a surge in inflation and following the surge in inflation nominal interest rates rise to capture that rise in inflation.

If there's any type of economic policy we should eschew, that's it, because whatever one may say about tradeoffs between growth and inflation, which is how in many instances these problems emerge, I don't think there's any question that a precondition for stability and an environment other than the type which you described, Senator, is no inflation, modest inflation, zero inflation, but certainly not the type of inflation which is generated by successively heavy and corrosive Government budget deficits.

Senator HECHT. Chairman Volcker used to say—I'd ask him how can we bring down interest rates, and he would say, "Cut another $50 billion off of the deficit." That was the stock $50 billion answer.

A few days ago in the paper it mentioned that in 1987 we're getting an extra $20 billion in revenue from the tax law in capital gains, but that the deficit in 1988 and 1989 is going the wrong way.

Is it possible to have low interest rates and an expanding deficit?

Dr. GREENSPAN. Over the long run, Senator, the answer is no. It is quite possible, as we have observed in recent years, that in the short run the answer is clearly possibly yes. But ultimately, there is just no way that you can finance ever-increasing central Government deficits without ultimately expanding the money supply, in a sense dipping into the central bank to monetize the deficit; and that will ultimately drive interest rates sharply higher and the economy into a nosedive.

Senator HECHT. Did you see the particular article the last few days about the deficit going in the opposite way in 1988?

Dr. GREENSPAN. Senator, what you're discussing is the Congressional Budget Office's projections which squared fairly closely—not as closely as I thought they might—with the Office of Management and Budget's estimate for fiscal 1987, both reflecting these extraordinary capital gains taxes which occurred in order to beat the deadline of January 1, 1987 when the capital gains tax rate went up.

As a consequence of that, the base is much lower than we had anticipated it would be. Therefore, while a number of realistic projections—and I think CBO's is one of them—say that without any action on the part of the Congress either on expenditures or on the tax side, that we will probably have a somewhat higher deficit in fiscal 1988 and 1989 than we will have in fiscal 1987.

Senator HECHT. But isn't this the wrong signal to send out? We have been very successful in bringing the deficit down. Now if it goes the other way, what is that going to mean?

Dr. GREENSPAN. I think it's a very dangerous signal, Senator.

Senator HECHT. Would you care to expand on that, what the ramifications are?

Dr. GREENSPAN. Well, one of the reasons why we have had interest rates easing in recent years is there has been increasing evidence that we have been struggling successfully against the budget deficit. It has remained inordinately large, but it's been coming down. It's been coming down not only as a percent of the GNP, but it's been coming down in absolute terms. And markets tend to project into the future.

It's premature to forecast with certainty that the budget deficit is going to rise because the assumptions one makes in order to forecast the deficit are very fluid. And I can change CBO's economic assumptions ever so slightly and bring the budget deficit track that they are projecting downward.

So we shouldn't take their forecast as being a major danger signal in reality. It's merely an early indication that we have to do certain things.

Nonetheless, should the actual numbers start to turn up and the underlying evidence suggests that the deficit is getting out of control again, then we are going to find ourselves in a very serious financial bind.

Senator HECHT. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hecht.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Dr. Greenspan, in your opinion, is the annual deficit that we've been running up year after year and the resulting $2.5 trillion debt or close to it that we have facing us the largest problem facing our economy today; and do you advocate an increase in taxes to reduce the deficit; and have you any comments or thoughts regarding how we might be able to deal with that $2.5 trillion debt?

We keep talking about the deficit, but not a lot of talk has gone into the debt and I know you've got to have one before the other. I'd like to share your comments with us.

Dr. GREENSPAN. Senator, when we deal with the issue of the Federal budget deficit, it's not one year's set of numbers which matters. It's really the broad, longer-term thrust because it is precisely the issue that you allude to—namely, the level of the public debt—

which has a very important impact in the degree of potential inflation, especially in a sophisticated financial environment.

There is no question in my mind that it is the most important economic policy variable, so to speak, to get that long-term trend down credibly so.

Senator SHELBY. In a manageable way?

Dr. GREENSPAN. Yes, in a manageable way.

Senator SHELBY. And what is that? What is manageable?

Dr. GREENSPAN. Well, manageable at this stage is any set of deficit numbers which are going down and if we can get the deficit, say, under one percent, that's close enough to balance so that we have made it, so to speak.

However, it doesn't follow that we can necessarily resolve this issue from the tax side. And the reason I am somewhat concerned about endeavoring to solve the budget deficit wholly or substantially from the tax side is I'm not sure it will work, because I'm sure you have all been aware of the tremendous pressures that have been built up in recent years to spend funds which have been restrained because they are not available, and I am by no means convinced that raising taxes will cut the deficit in the long run.

I don't deny that if you raise taxes you will get 1 year's impact, but then it will erode. That's the reason why I think it is essential that in any package that is involved in reducing the deficit that the emphasis has got to be on the expenditure side if for no other reason than that you are likely to fail in your goal.

What I am basically saying is, it is not a symmetrical case where you either balance the budget from the tax side or the expenditure side and those are equal policy tools. I am saying that they are not.

Senator SHELBY. Dr. Greenspan, does it trouble you that we have added—trouble you greatly I should say that we have added as a nation nearly $1.5 trillion in about 5 years to the national debt and it took about 195 years to go the first trillion? As an economist and as a former Chairman of the Council of Economic Advisers, does that bother you, notwithstanding what you're going to walk into in a few days?

Dr. GREENSPAN. It bothers me, Senator.

Senator SHELBY. And is that profound and one of the most significant things that we have failed to deal with?

Dr. GREENSPAN. We've started to deal with it. We haven't gone far enough and I suspect——

Senator SHELBY. But we haven't touched our debt. Now we're talking about our deficit, but we haven't touched what we already owe, right?

Dr. GREENSPAN. Yes. Senator, I don't think it will turn out to be necessary to actually reduce the outstanding Federal debt because, remember, in order to do that, we must run a unified surplus. Now I must say to you that if the Congress chose to do that and were able to, I would be the first to applaud. But at the moment at least, as a forecaster, that is not my most probable outcome.

Senator SHELBY. But that's a bomb ticking out there, isn't it?

Dr. GREENSPAN. The way to measure the level of the total public debt outstanding, or more exactly the debt owed to the public, is as a percent of the GNP; ultimately where the problems lie is in debt service, and arithmetically if interest rates were constant, then you could use the ratio of outstanding debt to GNP as a proxy for interest payments as a ratio to the GNP and get some judgment as to what the debt service problems were.

Senator **Shelby**. Dr. Greenspan, my time has expired. I'll have to wait until another round.

Thank you, Mr. Chairman.

The **Chairman**. Senator Karnes.

Senator **Karnes**. Thank you, Mr. Chairman.

I would like, Dr. Greenspan, for your personal assessment of the condition of the Farm Credit System, just in general terms, and what suggestions you would make to address some of the problems? I reference an article in the Wall Street Journal last Wednesday which talked about a need for collateral enhancement or actual monetary support to the tune of approximately $6 billion and likened it to something along the lines of a Chrysler bailout. I'm not sure I would agree with that. Indeed, several of us have proposed some legislation that would provide some alternative means of accommodating that system.

But in your position as the chief regulator and also the Chairman of the Fed, I'd like to hear your assessment of the system and what you think could be done.

Dr. **Greenspan**. Well, first of all, Senator, as you know, only about a fourth of the debt is owed to agricultural commercial banks, and they have been doing somewhat better. In other words, the rate of deterioration has slowed very dramatically and in fact the rate of deterioration in the whole farm credit situation has slowed. It's certainly not turned up.

I think the most important statistical piece of information that I've seen of recent days is the clear flattening out and in some instances evidence of an upturn in certain land prices in the farm areas. After a 50-percent decline in some of the major areas of our agricultural economy, one would certainly expect that the bottom in land prices would probably have been reached and I suspect that's a reasonable expectation.

What that suggests is that the underlying environment is no longer deteriorating, but it nonetheless leaves some very considerable problems in its wake and I must say to you I would hesitate to give you any insight at this particular stage in what I think the appropriate measures are because I have not yet had the opportunity to look into the details at a level which I think is appropriate to make the type of judgment you are asking me to make.

Senator **Karnes**. You have not had the opportunity to share personally I think your agenda or some of the goals that you would have as Chairman. Maybe that is something that you have a difficult time establishing, but I believe that you do have some and I know the media has characterized certain of your goals and I'd like to hear if you do have some general statements that you would like to provide. I would be very interested in hearing what your agenda would be.

Dr. **Greenspan**. Well, Senator, I've been watching the Federal Reserve now for several decades, mostly from the outside—on rare occasions, in a consultative capacity—and what I'm impressed by is the extraordinary culture of the Fed which recognizes that its role is basically to endeavor if at all possible to impart the type of financial environment which fosters long-term economic growth and stability.

As I indicated earlier, a necessary condition of that is a noninflationary environment. And since the Fed has such a crucial role in the monetary aggregates and in finance in general, it is absolutely essential that its central focus be on restraining inflation because if that fails, then we have very little opportunity for sustained long-term economic growth.

As a consequence of that, I would say that the type of policies that Chairman Volcker has initiated, as I've said previously, are essentially on target and I would hope, should the Senate confirm me, to follow in the footsteps of those individuals who held very much that same view.

Senator **Karnes**. Thank you, Mr. Chairman.

The **Chairman**. Senator Graham of Florida.

Senator **Graham**. Thank you, Mr. Chairman.

I would like to pursue the two questions that I raised in my opening statement, Mr. Greenspan.

First, I have been struck that a number of the issues that we deal with—and I would put, for example, the corporate takeover frenzy under that category—are manifestations of a larger circumstance in which economic consequences are judged on what appears to be a shorter and shorter time frame.

And one of the corollaries of that is a discouragement for those who are going to be evaluated to take actions that might have beneficial results over a 5 or 10 year horizon but are detrimental to immediate results.

I wonder if you could comment as to whether you concur in that assessment and, if so, what recommendations, either through the position that you are soon going to assume or to this Congress or other private or public sources of influence in our economy, the steps we might take?

Dr. **Greenspan**. Senator, the issue you're raising, when translated into economic variables, is what we call the real rate of interest.

The reason I put it that way is that when we have very high real rates of interest, we are in effect forcing business and economic decisions to be very short range because, in effect, you cannot get any payout from earnings which are generated in the long term.

I think through most of the 1980's we have been experiencing, one, high real rates of interest and up until very recently a very high yield in the stock market that is the inverse of price-earnings ratios.

In the last year or two, however, the situation has improved. I don't envisage it as being back to where you would, I presume, like it and where certainly I would, but we are moving in the right direction. And at the moment, I am not aware of any particular economic policies other than removing the excess Federal budget deficit burden on the economy which would move that in a still more propitious direction.

So while I understand your concerns and agree with most of them, I would just merely add that the most recent data suggests that at least the situation is moving in the right direction.

Senator **Graham**. I would like to move to the second question and that is the integration of the U.S. domestic economy into world factors and what that says about the relative role of marketplace and Government in the mix of arriving at economic policy.

You talked earlier on the Third World debt and expressed some optimism at the progress that had been made in managing that issue.

What would you consider to be the standards, the milestones that we should use to evaluate success, neutrality, or failure in the Third World debt issue? You seemed to emphasize the balance sheet of the banks and the degree to which the debtor nations were moving toward a less planned and a more marketplace economy as two standards. Are there any others that you would recommend?

Dr. GREENSPAN. I think there's a very important and very clear sign that success has arrived, and that is the ability of these debtor nations to reenter the financial markets on a voluntary basis, meaning the ability of one of these debtor nations to sell, say, 5-year Eurodollar notes at interest rates which they can afford. The day that they are back in the market is the day the problem is essentially solved and that would be the criterion which I would use and, in fact, that would be the goal which I would hope those involved in endeavoring to solve this problem, both on the part of the debtors and the creditors, would take as a standard.

Senator GRAHAM. Mr. Chairman, my time has expired. I had one last question I'd like to ask which was in sequence.

The CHAIRMAN. Is there objection to proceeding for one last question?

Senator GRAMM. Let's hear the question. [Laughter.]

The CHAIRMAN. Without objection, go ahead.

Senator GRAHAM. Thank you. The question is, what, if any, lessons do you think we should learn from the last 10 years of experience of lending to Third World nations, the crisis, and now what you think is the recovery period? Are there any new policies, revised policies, that we should implement based on this past decade's experience?

Dr. GREENSPAN. Senator, regrettably, the answer is no. And the reason it is no is that history tells us that we become overenthusiastic about certain types of financial arrangements, certain types of ideas, and we overdo it. I guess it's human nature. And in an area as complex as credit evaluation and international lending, I suspect it's understandable that we would eventually run into trouble in this area.

But I would be hesitant to say that there is some great new insight other than just plain prudence that has to be surfaced here and I think there's no profound new institutional issue which has surfaced as far as I can judge.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gramm.

Senator GRAMM. Thank you, Mr. Chairman.

Mr. Chairman, let me first begin by thanking you for the expeditious way you have moved on appointments by the administration. I don't think any committee in the Congress has matched your committee for moving on the hearings and reporting people out that were broadly supported, and I would just like, for one, to begin by saying thanks.

The **Chairman**. Well, thank you very, very much, Senator Gramm. I appreciate that and we'll try to match that record with the present very important nominee we have this morning.

Senator **Gramm**. Dr. Greenspan, I want to begin by asking you a question about the money supply. Maybe it's just the haunting memories of my graduate school days that come back and worry me once in a while, but from time to time I get worried about how we let the monetary base go up and down like a windowshade. And, in fact, we had, as I recall, M1 in December of last year growing on an annual basis of 30 percent and by February it was declining and, in fact, in looking at the money supply and the monetary base in the spring, I was becoming worried that in fact we were constraining too much and that has now been reversed on the last monthly figure that I have looked at.

Now should I forget about monthly and quarterly data and worry about something else, or are you concerned about the extreme variability in the monetary base, the money supply, and were you concerned this spring that in fact we had too much constraint on the money supply?

Dr. **Greenspan**. Senator, anyone who looks at the money supply figures will invariably look at the most recent data, irrespective of what we say to ourselves. In other words, we can say that we really don't care what month-by-month fluctuations are doing and we only care about the longer term trend. That's what we should care about.

But longer term trends are not visible to us and all we have is the most recent observation and we tend to extrapolate that. And as a consequence, we use that sort of evaluation as a proxy for the longer term view.

There is no way we can avoid that and what we have to do is to recognize that there is an inherent volatility that seems to crop up in normal Federal Reserve actions.

There's been, as you know, Senator, from your graduate school days and later, very considerable disputes amongst monetary economists about the whole question of whether the Fed should engage in very stable growth in the money supply or whether it should endeavor to have an admixture of impact on interest rates and money supply.

Senator **Gramm**. Could you give us your view on that, Dr. Greenspan?

Dr. **Greenspan**. Yes. In the very long run I tend to believe that the stabler that one can make the change in money supply, the better off the economy is likely to be.

I also recognize, however, that there are occasions when the normal relationships between the economy and money supply veer off in a direction which requires temporary aberrations. In the past there have probably been more presumed aberrations than in fact really existed, but one of the very great difficulties that the Federal Reserve has is to make judgments as to whether what they are looking at is the beginning of a trend or an aberration, and the most successful monetary policies usually turn out to be those in which these judgments are far more accurate than inaccurate.

And in many instances, it is very difficult to judge, but the bottom line in stability is better than volatility.

Senator GRAMM. I can't resist the opportunity, since the Senate may well be voting tomorrow on the so-called Gramm-Rudman-Hollings fix—as you are aware, this is an effort to put the automatic mechanism back into the law that serves as either the club in the closet if we don't get the job done we have an automatic cut which nobody wants, or the shield which allows the politician to go out and say, "Well, I'd like to give you all these things but if I do we have an across-the-board cut and it hurts other people."

Could I get you to express your views as to whether or not we should rearm this deficit reduction mechanism and how important that is?

Dr. GREENSPAN. I have always thought that while from an economic policy point of view there were a lot of problems with your bill, Senator, but looking at it as a practical means of getting the budget deficit down, it seems to have done some good.

I supported that type of procedure when you initiated it. I support it today.

I can conceive of conditions in which the means by which it is implemented would create the type of structure of spending which I would find undesirable and therefore would argue that that probably would be a bad idea. But if you're merely asking me as to whether or not I favor the process, the answer is, yes, I do.

Senator GRAMM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Gramm.

Senator Sanford.

Senator SANFORD. Dr. Greenspan, I suppose you will have as much to do with the massive national debt as anyone else, probably will have to worry about it as much or more than anyone else.

I didn't quite understand from your answer to Senator Shelby just how big a problem you consider that to be now.

Dr. GREENSPAN. Senator Shelby, as I recall, asked did I think it was the major economic policy problem that the country has. And my answer, with a lot of curlicues in it, was yes.

Senator SANFORD. And you've indicated that it was properly related finally to GNP and that the amount was not as important as the percentage?

Dr. GREENSPAN. That's correct. In other words, the burden that the total public debt has on the economy is relative to the total size of the system.

Now if we want to get very sophisticated, there are other denominators we would want to put under that. But GNP is a good proxy for most of them.

Senator SANFORD. Well, what is your idea of what is a proper relationship to GNP, forgetting the ramifications of the collateral matters?

Dr. GREENSPAN. Senator, I think you have to look at the issue in two different ways. One, the level of the debt is important, but the rate of change in the debt—that is the deficit or surplus—is more important.

The reason is that in the financial markets, even though there is a balancing of what we call portfolios—so-called portfolio adjustments within the economy in which the holdings of Federal Government debt are shifted into corporate debt or into other instruments and that affects the way the system functions—the net borrowing requirements of the U.S. Treasury have a direct impact on interest rates and on financial flows in a way in which the portfolio adjustment does not.

They are both important, but the deficit or the net change in the outstanding public debt is more important.

Senator SANFORD. Well, I suppose the specific question that both of us were trying to get at is, do you think we ought to be taking some kind of action to reduce the national debt, which has risen in 6 years from 26 percent to 42 percent of the GNP, and is 42 percent a mite high?

Dr. GREENSPAN. Senator, that translates into whether I am in favor of you moving to a Federal budget surplus, because obviously until you can get a surplus the debt does not go down.

I can't conceive of that happening very readily and I recall that in answer to another query—I don't think it was before the Banking Committee, I think it was the Senate Finance Committee—I gave an answer I'd like to repeat which was that any deficit reduction which is politically feasible is almost certainly economically sound.

The reason I put it in those terms is that you will find a number of economists would argue that going from the deficit that we have now to a surplus would create too much so-called fiscal drag.

I suggest that that is not an issue to worry about and if you can find a mechanism to move us toward a surplus, I would certainly applaud your efforts. As I said before, I think it would be extraordinarily difficult to do, but there are a great many advantages to achieving that.

Senator SANFORD. Well, thank you. Let me ask, there will be a great many questions relative to the banking industry and investment industry and we are working now on legislation. I could ask perhaps 30 specific questions but let me just ask one as illustrative of how you see your role in this kind of activity.

The three bank regulatory agencies have jointly proposed a risk-based capital regulation. You have previously stated that you believe the banking industry in this country is undercapitalized I think.

Do you favor the concept of risk-based capital and would you be inclined to support a risk-based capital regulation or guidelines as a way to enhance banking industry capitalization? Or do you believe that risk-based capital would get the Government too much in the business of credit allocation or whatever?

Dr. GREENSPAN. No, I support risk-based capital ratios, Senator, because I think that to the extent that we impart current capital-asset ratios, we are finding without much surprise I suspect that the banks are playing the system. That is, they are going off-balance sheet to reduce the asset side, that they are in fact not acquiring on their asset side interbank deposits which are often very useful and very low risk largely because it affects their capital-asset ratio.

If we engage in risk-based capital, we will find that a lot of these distortions will disappear and there is no question, it is a far superior means of regulating capital in our commercial banking institutions than what we are using today.

Senator SANFORD. Thank you very much.

The CHAIRMAN. Thank you.

Senator Bond.

Senator BOND. Dr. Greenspan, this committee, as you are very well aware, has had outstanding testimony in recent months about the problems with declining bank profitability, and we have heard about ag loans, energy loans, foreign loans. In addition, tendency of blue chip corporations to issue commercial paper rather than take out short term bank loans has had an impact on bank profitability.

As you know, we are considering legislation about the role, structure, and regulation of financial institutions, and I would like your views on the public policy implications of declining bank profitability. Is this something that we should worry about?

The second part of the question is, do you feel that granting some types of expanded powers would have a favorable or unfavorable impact on the role the banks pay in our economy today?

Dr. GREENSPAN. Senator, the answer to your first question is that, yes, we definitely do want to, if we possibly can, enhance the profitmaking capabilities of our banking system, because, to the extent that they are profitable to that extent they are viable and create a competitive environment, which enhances finance and economic growth in the country. It is very important that we have a financial system which has significant amounts of profit in it, enough to attract innovation and the type of structure which is essentially required in the type of economy which is currently evolving.

There is something very fundamental that is going on and has been going on in recent years, which is going to be a key element in any decisions that this committee makes with respect to recommendations for restructuring the banking system, and that is the extraordinary improvement in information technology. Largely driven by computer and telecommunications technology, we now find that much of what the banker had as sort of his tool of trade, that is, credit analysis, has enabled banks, basically, to engage in the type of intermediation which created our banking system. We are now finding that that particular scale, that particular economic value is falling in cost as a consequence of technology, and that fall is irreversible.

It is enabling the banking system, or more exactly, the financial community, to unbundle the various elements of commercial bank intermediation. In other words, the value which a commercial bank contributes to our system and the value which has created the expansion of banks in the society, is really a combination of a number of risk diversification and reduction products, and we are now finding that they are beginning to be far more cheaper, basically unbundled, than they are in the total system.

As a consequence, that has led to what we call securitization, which is essentially a bypassing of the normal intermediation process of the banking system and has led to, as you point out, the commercial paper expansion, which is a form of, at least—it is not securitization, but it is close enough. It has created a problem which our banks are going to be confronted with and, therefore, if we freeze the system in this growing technology, we will undercut the profitmaking capabilities even further than they have been undercut and would do great damage to the banking system, which leads me to your second question.

The answer is, yes, I do believe that expanded powers are necessary in the context of maintaining the safety of the banking system, and that can be done, should be done, and, in fact, is by far the less risky road to take than standing pat with the hand that we have now dealt the commercial banking system.

Senator **Bond**. Thank you, Dr. Greenspan.

The **Chairman**. Senator Sasser.

Senator **Sasser**. Thank you. Thank you, Mr. Chairman.

Dr. Greenspan, we have heard a lot this morning about the leadership and independence of Paul Volcker as Chairman of the Federal Reserve Board, and I, for one, would not dispute for a moment that Paul Volcker will go down in history as perhaps one of the finest chairmen that we have had at the Federal Reserve, but lest we forget, there weren't many of us around this dais in 1981 and 1982 who were praising Paul Volcker. None of us around here at that time wanted to pin any medals on him, and I was one of them who was criticizing. And quite frankly, I do think that in 1981 and 1982, the Fed went too far with an overrestrictive monetary policy, pushed us into the worst recession or depression that we have had since the 1930's, and that thing came very near to getting out of control, in my judgment.

The question that I would want to ask you, Dr. Greenspan, do you see us pursuing a policy, in the foreseeable future or during your tenure, of pushing interest rates up to a very high rate, as we experienced in 1981 and 1982 up into the stratosphere of 18 percent, 17 percent, and that sort of high interest rate approach to trying to control inflation?

Dr. **Greenspan**. Well, I certainly hope not, Senator.

Senator **Sasser**. I hope not too.

Dr. **Greenspan**. Let me, however, review that period, because while I certainly sympathize with your concerns of the extraordinary problems that emerged at that time, the problem was not 1980 or 1981. It was not the time when we were running into real difficulties. It was the time before that. What Paul Volcker and the Federal Reserve were confronted with was a situation which had gotten out of hand. In other words, the real policy problem, in my judgment, was not the Federal Reserve putting on the clamps, but the policy which created the type of environment that made that necessary, because in the wake of the oil price rise and a number of other things, we allowed our system to take on inflationary biases which threw us into such a structural imbalance that, in order to preserve the integrity of the system, the Federal Reserve had to do what it did. Had it not acted in the way which it did at that time, the consequences would have been far worse than what subsequently happened.

The lesson that we have to learn from that period is not, whether we get involved with 18 percent interest rates, but that we make certain that we do not get into an economic policy malaise or into a set of policies which were unfocused, which leads us into the type of environment in which that is the only thing that stands between the economy and catastrophe.

And as much as I was concerned, as you were, Senator, about the problems that occurred as a consequence of that action, the economic policy problem was the earlier policies in which we failed to restrain inflation rather than those actions which, in my judgment, actually made the situation better than it would otherwise have been and, in my judgment, were necessary.

Senator **Sasser**. Well, I won't debate the point with you, Dr. Greenspan. I think there were great inflationary pressures in the economy and there were very serious problems, and I do think that Mr. Volcker and the Fed acted properly in trying to restrict the money supply, to a certain extent, and with a resultant uptake in interest rates.

I think my problem with it was, I felt that it was excessive, what it went on too long. In an effort to wring the last iota of inflation out of the economy, we very nearly put ourselves into a serious economic tailspin that was difficult to recover from.

Let me move on to one other topic, if I can, very quickly, because my time is limited.

Dr. Greenspan, you have written very knowledgeably on the question of takeover and, in fact, you have testified before this committee on this subject, and I would like to quote from your January testimony with regard to the problem of increasing corporate debt.

You said, quoting:

> While all of the debt accumulation has not reflected takeover and merger activity, a very substantial part of it is directly or indirectly related to that process.

Talking about takeovers or fighting off takeovers.

You went ahead to say:

> The huge increases in corporate debt has essentially offset the benefits that could have occurred to corporations from the dramatic decline in interest rates over the past five years.

You also testified that many of the companies that have been taken over or that are saddled with the debt to fight off the takeover, were, and quoting you, "far better run than the average American corporation."

Now that conflicts with the argument that we hear from some of the takeover people that takeovers are a way to deal with the problem of inefficient management at the corporate level. "Business Week" says that corporate debt, as a result of dealing with the takeover problem, has increased by over $400 billion in the last 2 years.

I want to address this question to you, and this is the question. What does this enormous increase in debt, corporate debt, mean to us in the next downturn in the business cycle? Are we going to see a terrific rash of bankruptcies, as a result of these corporations saddling themselves with large debt, in an effort to fight off a takeover or to protect themselves from a takeover?

Dr. **Greenspan**. It is very difficult to say, Senator. Obviously, they have increased their risks. The ratio of equity to debt has declined in the nonfinancial corporate system, and clearly, we are far more vulnerable, in the event of a significant downturn, than we were earlier in the post-World War II period.

Senator **Sasser**. As a result of the debt?

Dr. **Greenspan**. Yes. As a result of the fixed charges, specifically, debt service, which obviously does not decline when gross operating incomes fall, and the so-called "coverage" of the interest payments becomes insufficient in numerous areas.

As I think I indicated in my testimony, Senator, there is, not a large, but a significant amount of interest payments currently being made by nonfinancial corporations, which is borrowed money. And that tells you that we are increasing debt at levels which should make us all uncomfortable. It certainly makes me uncomfortable.

The **Chairman**. Senator Sasser, before I call on Senator Heinz, let me just say that that was an excellent question on debt and a superlative answer. We very much appreciate it, you are exactly right. Senator Heinz.

Senator **Sasser**. We make a pretty good team, Dr. Greenspan. [Laughter.]

Thank you, Mr. Chairman.

The **Chairman**. Senator Heinz.

Senator **Heinz**. Thank you, Mr. Chairman.

Mr. Greenspan, the job the President has nominated you for involves a number of responsibilities. One, as at least I see it, would be the management of the Nation's money supply in a way to support sustainable economic growth and price stability. Another would be to promote the efficiency of the capital markets and the third would be to promote the stability of the capital markets, and hence, you've got a lot of questions about LDC debt on the latter question.

I wasn't here for all the hearing. You have had perhaps some questions on the issue of efficiency of the capital market.

My first question to you, though, is, is it—is there any inherent conflict between having more stable capital markets and having more efficient capital markets?

Dr. **Greenspan**. That is a very good question, Senator. Technically, one would assume that the answer has got to be yes, obviously, because efficiency presupposes the ability to adjust optimum positions which are always changing, and that, obviously, implies volatility.

I would suspect in practice, however, that because the markets are so extraordinarily efficient, that any disruptions which tend to occur as a consequence of shifting from one efficient state to the other, so to speak, are really more likely to be smooth than discontinuous.

So while I suspect there is a problem, possibly, there, my impression is, it's really a quite minor one.

Senator **Heinz**. Well, one argument for the greater efficiency of capital markets is that we should repeal the Glass-Steagall Act, because the Glass-Steagall Act, at least in theory, impedes the efficient allocation of capital by preventing commerce and banking from being intermingled.

Now in theory, theorists tell us that that should promote efficiency; is that right?

Dr. **Greenspan**. I think it is.

Senator **Heinz**. And if it is right, will it promote stability, as well? And if so, what kind of stability?

Dr. GREENSPAN. Well, I think it does promote efficiency. I think you are quite correct in saying it adds slightly to instability, but it also has——

Senator HEINZ. I didn't say that. I was asking.

Dr. GREENSPAN. OK.

Senator HEINZ. I was asking.

Dr. GREENSPAN. I will put it in my words. [Laughter.]

But first of all, the difference between a bank loan and a security is getting less and less observable. Whether or not corporation X borrows from a bank which then, in a sense, finances it and funds it with deposits from a saver, or whether or not X sells a bond directly to that saver, is really not a terribly significant difference in the form of the instrument involved. And in one sense, underwriting securities, not in all senses, is less risky than making loans, not holding that instrument on your books as much as one would do with a loan. But even bank lending these days is turning more and more into origination of loan and sale of loan, and that, technically, is exactly the same as underwriting.

Senator HEINZ. I was really asking beyond the financial services area for your views. I was thinking more of whether commercial firms, not securities firms, but commercial firms, General Motors should own banks or banks should own General Motors.

Dr. GREENSPAN. If there were no Federal safety net, that is, no Federal deposit insurance, no access to the payment system, no discount window, I would say that there should be no regulation whatever. That a General Motors Acceptance Corp., which is a vehicle which is owned by General Motors, is very close to a banking institution without those Federal safety net issues.

Senator HEINZ. I would agree. Of course, that is not the world we live in nor——

Dr. GREENSPAN. No. But I was about to get to the next statement. Because the Federal safety net is essentially a subsidy, I would not approve of the issue of using that subsidy to help a nonbank affiliate. That does not mean, however, that I am not very much in favor of exploring the issue of bringing nonbank affiliates and bank affiliates together, provided that we construct an effective firewall. As you know, Senator, there is very great dispute on whether that is feasible. I happen to believe it is. If I am wrong on that question, and the evidence suggests that I am wrong, then I will change my view. At the moment, I think I am right, and to that extent, if it is feasible, I think that the additional capital which can be added to the commercial banking system would be a very valuable addition to the vitality of that system.

Senator HEINZ. My time is expired, but I have one last question that I think you may be able to answer yes or no.

Is it the commercial banking system that needs more capital, or is it the savings and loan industry that needs more capital?

Dr. GREENSPAN. They both do.

Senator HEINZ. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wirth.

Senator WIRTH. Thank you, Mr. Chairman. And Dr. Greenspan, I, for one, am delighted that you have agreed to take on this responsibility, assuming that you are confirmed, which I would suspect you will be, and we look forward to working with you.

One of the issues we face on this committee, which has been touched upon by Senator Bond and Senator Heinz and others, relates to the question of Glass-Steagall and where do we go from here. Clearly, we don't live in an ideal world of starting from scratch, nor are we going to completely repeal Glass-Steagall. We live in a world where there are such constraints built in by the FDIC and access to the discount window, and so on.

What we are searching for, I think, is the model or the approach for, you know, how do we proceed. And one proposal that has been raised before the committee in quite extensive testimony was that offered by Mr. Corrigan of the New York Fed, and I was wondering if you had reviewed that proposal and if you had any reactions to the ideas that he brought before the committee and has articulated around the country over the last couple of months.

Dr. GREENSPAN. I thought it was an extraordinarily thoughtful proposal. Obviously, there were elements in it which I disagree with. On the issue of commerce and banking, he comes out on one side; I come out on the other, and it really gets down to an issue not of philosophy but of facts as to whether or not an optimum firewall can be built to gain some of the advantages of that capital.

Aside from that, I think it is a terribly thoughtful proposal, and if the committee were endeavoring to use a starting point from which it would try to think of what would be an optimum system, that's as good a piece of paper as I know, to start with.

Senator WIRTH. It seems to me we have to start somewhere, particularly if the FDIC legislation becomes law, and we have that window of the freeze or the moratorium, we have a relatively short period of time and have to start with some kind of a document. And I think your views are very valuable.

Let me move to a second, perhaps a little more cosmic issue and that relates to what we would were we to have a recession. As I look at the financial community now and look at the overall level of debt in the United States compared to GNP, which has gone up pretty sharply over the last 6 years, look at the number of failures in banks, that number has increased pretty sharply since 1981, look at the problems of S&L's, which are very familiar, and the whole international bank debt problem, plus our own deficit problem, we get pretty worried. As least I do. I can't find myself feeling the same, as some do, about, you know, everything is going to be all right down the line. I think we are in for some very, very real problems.

Were we to have a recession similar to that that, say, we had in 1974—no worse than that, that we had in the early 1980's, what mechanism is available to deal with that? Or specifically, what would you do, as head of the Federal Reserve, through monetary policy, to deal with a recession and what other steps would you recommend to the Congress?

Dr. GREENSPAN. Senator, all recessions are different. They all have different characteristics, and as a consequence, require different responses.

I would hesitate to answer you in a very generic sense. I don't believe that the business cycle has been eliminated—somewhere down the line, we are going to have another recession. Whether it is as large as 1981 or half as large, I don't know. What I do know is that it will have characteristics different from any that we have seen previously and what monetary policy you craft to adjust to that, and indeed, obviously, policy has to adjust to that, is going to depend on the nature of what actually is going on. And I suspect that we are going to find that it is not an automatic policy, where one looks on page 5 and says, "Recession policy. See paragraph 4." I wish it were that way; regrettably, it is not.

Senator WIRTH. Well, to pursue that a little bit further, anticipating the kind of problem you are suggesting, given the cyclical nature of the economy and given the history, is going to occur, and whether it is as grave as the one in early 1981 or less grave or perhaps more grave, we, it seems to me, have to be thinking about the fact that we do not have unlimited resources to deal with that particular problem. And if we get into a recession, it seems to me, given the nature of the deficit, it is pretty hard to prime the pump in a classic fashion, and we can't do that, it's pretty hard to cut taxes. We can't do that. We've already done that.

The more traditional tools that we had all grown up to know could be used don't seem to be available, and I don't think—I don't know where they are. Therefore, you know, one of the few remaining items is monetary policy and how to deal with that, and it seems to me that the burden of that next recession is going to fall, perhaps unfairly and perhaps unduly, on the shoulders of the Federal Reserve, and I think that we all have to think very carefully about, you know, what you can do, what kind of response is there that the Fed can take, if we are limited in the ways that we can respond by the nature of where we are right now in our own fiscal and tax policy.

Dr. GREENSPAN. Senator, that is the reason why I think it is important to recognize that the best way to deal with a recession is before it. Several years, 5 years, 3 years, 2 years.

The other side of this debt question is equity. That is the reason why I answered before that I thought that we need more capital. We need more capital in the total system. We need more capital in the nonfinancial system and in the financial system, largely because of the problems you outlined. There is no substitute for that.

Having said that, I am also acutely aware that it is not easy to implement, that I may say that we need more capital in the commercial banking system, but I am also aware that that is not easy to do, because, clearly, if you order banks to sharply increase their capital, they don't increase their earnings as a consequence, and you very sharply dilute their rate of return on equity, and it makes it very difficult for them to raise the capital. And so it is a very tough process, but it is a process which I think we ought to move in the direction of, if we can find a way.

And the reason I say that is, we may or may not be able to find the appropriate set of tools to counter that hypothetical recession you have described, but what we can certainly do is to restructure or structure the economy, and specifically the financial system, in a way that would enable it to take whatever blows are contributed by that recession far more easily than we would be able to do in the structure that we are now looking at.

Senator WIRTH. Mr. Chairman, thank you very much. Again, Mr. Greenspan, thank you, sir. I look forward to working with you.

The **Chairman**. Thank you, Senator Wirth.

Dr. Greenspan, I am going to be the skunk at the picnic at this love feast that we are having here this morning and give you some questions in the "nobody's perfect" department.

Federal Reserve Board policy depends on the judgment of the Board about the outlook for the economy, whether it is implicit or explicit. You have to have some kind of a forecast in mind for economic growth, for interest rates, for inflation and unemployment, and so forth.

In other words, it depends on your ability to forecast. So how about your ability to forecast?

Now in the first place, when you were Chairman of the Council of Economic Advisers during the Ford administration, the Council had a dismal forecasting record. I have here a study by the Joint Economic Committee, which showed, in the 3 years 1976, 1977, 1978, the forecasts of the agency which you headed, were wrong by the biggest margin of any in the 11 years, 1976 through 1986. They tied the record for being wrong in 1978. They were almost as bad in 1977, and they were way off in 1976. That's on growth.

Then it comes to Treasury bill rate forecasting interest rates. There you broke all records for the entire period in error, when you estimated that you predicted that the Treasury bill rate in 1978 would be 4.4 percent. It actually was 9.8 percent. You were off by a huge margin. In 1977, you predicted it would be 5.3. It was 8.8. Again, way off. 1976 wasn't quite as bad, but you were off then.

Then we come to your forecasts on inflation. The Consumer Price Index. And there again, you broke all records. 1978 was the worst forecasting years that we had. You estimated that the rate of increase in the CPI would be 4.5 percent. It was 9.2 percent. And you were way off in 1977 and 1976.

Your estimates on unemployment weren't as bad. They weren't perfect, but they were better than most. But you were way off in those areas.

Now in view of the critical importance of being able to use the data to determine the likelihood of what's going to happen in the economy, and then adopt policies to cope with it, how do you answer to the fact that your forecasts were so far off?

Dr. **Greenspan**. First, I must say to you, Senator, that I don't dispute your figures, but that is not my recollection of the way the forecasts went. Was this a forecast made as of when? Do you recall?

The **Chairman**. Well, the forecast was for the fiscal year budget 1976, 1977, and 1978.

Dr. **Greenspan**. What was the date of the actual document, do you know?

The **Chairman**. The date of this document—the date of the forecasts were, date issued February 1975, January 1976, and January 1977.

Dr. **Greenspan**. So, successive years.

The **Chairman**. That's right.

Dr. **Greenspan**. Well, if they're written down, those are the numbers.

The **Chairman**. Yes.

Dr. **Greenspan**. There is a very substantial difference, Senator, between forecasting in the Administration and forecasting outside. [Laughter.]

The **Chairman**. I sure hope so! [Laughter.]

Dr. **Greenspan**. And I will explain to you, as best I can, with imminent sense of failure of my mission. [Laughter.]

It is very difficult to get across that what those budget projections are—which is the base for the budget projections—are essentially goals. That is, those are the projections that the President's economic policy, if implemented, is supposed to create.

The difficulty is that it is almost never implemented, and therefore, the premise under which the forecast was made never actually materializes, and therefore, I must say I have great sympathy for those who succeeded me in that office, who had to make forecasts, because essentially, it is a different type of forecast from being in the private sector or, in fact, being the Federal Reserve.

The **Chairman**. But let me just interrupt to point out that every one of the other chairmen of the Council of Economic Advisers had the same problem, and they didn't miss by as much as you did, not nearly as much. In other words, their forecasts were not good, but their forecasts were substantially better than yours.

Dr. **Greenspan**. I feel sorry for me and happy for them. [Laughter.]

The **Chairman**. Well, then you had an opportunity to be a forecaster with Greenspan & O'Neill. As you know, you put your forecasts to a direct test in the private sector. The fact is that the firm only survived a few years, and according to a "Forbes" article of April 20, "In 1985, its first full year in business, Greenspan & O'Neill turned in one of the least impressive records of all pension fund advisers."

Now here was an experience in which you were independent. There were other problems, I guess. This article that you are familiar with, I'm sure, "1 Plus 1 Plus 1 Equals 0." You and your partner weren't always seeing eye to eye, but apparently the results were not impressive. They said they took two great people, two wonderful people with fine reputations and somehow it didn't work out.

Dr. **Greenspan**. All I can say is, I acknowledge that that did not work very well, and I take my share of the responsibility.

The **Chairman**. Well, I hope on number 3, when you get to the Federal Reserve Board everything will come up roses.

You can't always be wrong.

Dr. **Greenspan**. All I can suggest to you, Senator, is that the rest of my career has been somewhat more successful. [Laughter.]

The **Chairman**. Senator Riegle.

Senator **Riegle**. Let me ask you about exchange rates. We have watched the volatility, particularly, the dollar versus the yen, and the rate has changed recently. It closed yesterday. It went 152.75, and there is talk—some people think that we ought to stay more or less in this zone, somewhere in the 150 to 140 range. I have asked that a chart be given to you that I will refer to in a moment.

Is there a danger zone—given the huge bilateral deficits that exists between countries like Japan and other nations and the fact that we are going deeper in international debt at the rate of $1 billion every 2½ days at the rate at which we are running now, if we were to see that exchange rate drop, say, to 130 and stay or 120, is there some point at which, if it were to get down into that lower range, that it would, in your judgment, kick off other repercussions? The one I am most concerned about is our ability to continue to borrow this international money that we are hooked on at interest rates that we can afford, or would we likely find at some point that we would have a serious problem where interest rates would probably have to go higher, if we found that happening.

And I'm wondering—I want to get your professional sense as to where in that zone of exchange rate differentials—if we get down into the range, again, of 130 or 120, does that present a problem, in terms of continuing to attract international debt at interest rates as low as they are presently?

Dr. **Greenspan**. Well, Senator, there are a number of people who argue that we are already at areas which should cause some concern.

Senator **Riegle**. Do you hold that view?

Dr. **Greenspan**. I am inclined to believe that if we were to go into a free fall, we would not solve our problems with respect to trade or balance of payments, because we would create other offsetting effects.

The difficulty that we have at this particular stage is that we know that the exchange rate is driven to a very substantial extent by the portfolio adjustments that are being made by the vast number of investment funds around the world. It is a huge block of external currencies—direct claims against the United States, direct claims against other countries and other currencies and the whole Eurocurrency and Asian currency system.

The private investors in that group are what drive exchange rates, when they shift from one portfolio mix to the other.

Senator **Riegle**. Right.

Dr. **Greenspan**. And there is a very considerable danger that should it be perceived that the dollar is heading in a straight line downward direction, it would exacerbate it.

Senator **Riegle**. Right.

Dr. **Greenspan**. Fortunately, what the evidence suggests at this stage is that we have run into a period of stability. That is, there is very little evidence to suggest that there is further downward adjustment in the immediate future, and I think that it will be very interesting to see what happens to our trade balances now that exchange rates have stabilized.

Senator **Riegle**. I want to go right to that, and I am very conscious of the time limit that we have. But my question is really not so much where you think we are likely to stay at the moment, but I am wondering, if we could test it in a way in the future that we were to see the value of the dollar change versus the yen, so that we got back down to the 130 range and stayed there or the 120 range, and we stayed there for a period of time, does that, in your view, constitute a kind of danger range, in terms of kicking off other repercussions that would cause you some serious concern?

Dr. **Greenspan**. Senator, I don't know the answer to that. I would hope we don't get down there. I see no reason why we will. There is one great advantage that we have at the moment, and that is that profit margins on imported goods have gotten down to very low levels.

Senator **Riegle**. Well, let me go right to that, the chart that you have got at your elbow there shows—and I am going to have a large version put up, and I have distributed copies to my colleagues here.

If you take the trade deficit through the end of last year, we were running at the rate of about $170 billion. And what this chart shows is the extension month by month into 1987, including the last month's data which we got a week ago, shown on an annual basis. So you can get some idea whether we are getting a J curve effect because of the change in currency values and other things beginning to turn the trade deficit around.

What I notice on this chart, is while there is a lot of talk about an improvement in the trade deficit, as you measure it this way, with these numbers, I don't see much improvement. I see us running at an annual rate over the first 5 months. It looks to me like we are more or less at a plateau. Now maybe we are getting some slight improvement, but we are not getting any—it looks to me more like an L curve than a J curve. And an L curve worries me, and it seems to violate the argument that we could expect, in a sense, an automatic improvement.

The reason I make this point, relative to the exchange rate differences is, it looks to me as if the exchange—the very substantial exchange rate differences that we have already had, have not had the effect of turning this trade deficit, and it looks to me as if there is not an awful lot of mileage out there in being able to force exchange rates further in that direction to solve the trade deficit. So that we've got a persistent problem on our hands.

The New York Fed has estimated that by 1990, we may well owe the rest of the world $1 trillion coming off this trade deficit, and in addition, our Federal budget deficit.

And my question to you is, when you look at this data, and you are in the data business and the data analysis business and have been in a very high profile way. If we have a $1 trillion international debt 2½ years from now or something close to that, is that something that we have to worry about? Are we going to find that there is going to be a very sharp effect that sets in at some point, either in terms of the dollar having to go lower, interest rates having to go higher, living standards having to come down?

Can we tolerate the continuation of this performance, if we stay where we seem to be at the present time?

Dr. **Greenspan**. Well, first, Senator, if we assume, as I do, that, say, exchange rates will remain stable for a while, we are likely to get margins on imported goods starting to rise again. One of the reasons why we had very little apparent response in your chart to this extraordinary decline in the dollar's exchange rate against the major countries, is that we started in early 1985 with a very high level of profit margins.

Senator **Riegle**. You mean foreign profit.

Dr. **Greenspan**. Foreign profit.

Senator **Riegle**. Right.

Dr. **Greenspan**. In other words, the margin of foreign producers and their distributors in the United States. It is the difference between their costs and the prices they sell in dollars in the United States.

As the exchange rates basically shifted in early 1985 against the dollar, rather than raise prices on imported goods, and in a sense price themselves out of the markets, to an extraordinary degree, foreign shippers to the United States, and I am excluding those whose exchange rates didn't change like Canada, Taiwan, South Korea, et cetera, those shippers largely absorbed the increased costs implicit in the weakening in the dollar and the rise in their domestic costs in fallen profit margins.

We have now come to a level where the early 1985 data very clearly indicated we were up at the upper range. We are now very obviously at a very low level. And it is quite possible that we are going to now find—and I think this is the more likely outcome, that those margins will begin to open up, which means that we will begin to get rising import prices without the dollar weakening.

If that happened very rapidly, obviously, that could create some inflationary problems for us, but it doesn't strike me as the most likely outcome. What does strike me as likely, is that import prices will rise enough to continue a significant decline in the physical volume of imports which we have had in this country since the fall of last year.

Ultimately, therefore, I think we are going to find, as we get—just as we get exasperated at the numbers you are showing, Senator, that very significant improvement in the nominal quantities will finally begin to show.

Senator **Riegle**. That may or may not help us in terms of the dollar valuation, though.

Dr. **Greenspan**. No, it ultimately will, because what history tells us about these conditions is that the physical volumes decline percentagewise more than the unit dollar prices rise, and that, therefore, the nominal values begin to decline; however, we haven't discussed the export side, which is crucial to these data.

Senator **Riegle**. Well, in the lower living standard side—I realize it is very complex, but it is sort of at the heart of how much maneuvering room I think the Fed has right now.

Dr. **Greenspan**. I couldn't agree with you more, Senator. You are raising the critical international problem that the Federal Reserve and administration policy, generally, has got of how to manage our way out of these dual deficits, the trade side, on the one hand, and the budget deficit on the other. And I would suggest that if we could do the budget deficit, over which we really have substantially more control, we would find that we were moving, certainly, in the significant direction which would assist this deficit as well.

Senator **Riegle**. I would agree with that. My time is up, and I don't want to trespass on my colleagues here.

The **Chairman**. Senator Shelby.

Senator **Shelby**. Thank you, Mr. Chairman.

Dr. Greenspan, is this Nation, the United States, the largest debtor nation in the world, presently?

Dr. **Greenspan**. You mean net debtor. Well, I don't want to quibble, Senator, but since I deal with numbers, I look at them, the answer to that question is, we are close. If we are not now, we will be, but there is at least some question as to whether we are.

Senator **Shelby**. If we are not first, who is?

Dr. **Greenspan**. Oh, there are a lot of others.

Senator **Shelby**. Sure.

Dr. **Greenspan**. The reason I am raising the issue is, basically, that when we take our foreign assets, less our foreign debt, we get a net debt figure which puts us in a very substantial position, but the assets that we record are, to a large extent, direct investment assets at book value. That is the reason why, even though we are technically, in a book value sense, in a net debtor position, we have more receipts from foreign sources than payments, which should raise a serious question as to whether our data are OK.

Senator **Shelby**. Were we actually a creditor nation generating excess capital for the world investors—we were the investors from 1914 until when—1980?

Dr. **Greenspan**. Oh, no. I would say, depending on how you look at the numbers, within the last year or so, if not now.

Senator **Shelby**. If the Japanese and the Germans and other foreign nations and their people and their institutions are buying up more and more of our debt, our national debt, our IOU's, do you perceive a danger that the Germans and the Japanese and the Swiss and the others would own a large percentage of our national debt and consequently would be able to manipulate, or would we be open to the manipulation of our interest rates and, consequently, our economy, to keep the dollar at a certain rate of stability?

Does this bother you at all? In other words, are we going to be held hostage to other people in the world and then, again, we have nothing—no control over our own economic destiny?

Dr. **Greenspan**. Let me generalize the question, Senator.

What we are and what we have been for quite a while is the custodian of the world's reserve currency. It is that, not the issue of whether we are net debtor or not, which is crucial, because two-thirds, maybe more of what I would call the world currency pool is denominated in U.S. dollars. And that means that unless we have sound economic policies, stable prices, a stable economy, we are going to find that periodically there is a flip side to this issue of being the reserve currency and that holders of U.S. dollars, whether they have claims directly against the United States or in the Eurocurrency markets or in the Asian dollar markets, they could decide that they would like to be elsewhere. And that could create very serious problems for American monetary policy, for American policy in general.

Senator **Shelby**. And would the fact that the amount of currency out there continues to grow, the currency pool and our money or our dollars, a larger and larger percentage of it, doesn't that leave us open again to being hostage to their ideas and their perceptions of how our economy is doing?

Dr. **Greenspan**. Senator, the answer is, clearly, when you are reserve currency, that goes with the game.

Senator **Shelby**. It's part of the turf, isn't it?

Dr. **Greenspan**. It's part of the turf, and the difficulty—the only reason I would hesitate to answer your question directly is that we have been in that position for quite a while, and the net increments that are occurring to aggregate external holdings of U.S. dollars, as a consequence of Senator Riegle's chart and current account deficit, that is off a much larger base than we have when we are really looking at what is our net debtor position.

So I think the real crucial issue is not so much the net debtor position, but is the aggregate external liability, plus the European dollar positions. They are very large and for the indefinite future, as the custodian of the world's currency, it is going to be incumbent on us to maintain sensible policies.

Senator **Shelby**. Dr. Greenspan, but the debt is a large part and parcel of our problem out there floating; isn't it?

Dr. **Greenspan**. I'm sorry?

Senator **Shelby**. Our debt, our world debt that is owed and picked up around the world is a big part of our problem, fundamental to what we are talking.

Dr. **Greenspan**. Yes. It is a significant part of the aggregate U.S. dollar holdings on foreign accounts.

Senator **Shelby**. Thank you, Mr. Chairman. My time is up.

The **Chairman**. Senator Graham.

Senator **Graham**. Mr. Chairman, I wanted to pursue the responses to the questions that I asked on the Third World debt. I interpret your answers to the questions of how we ought to evaluate success or failure and what lessons to be learned from recent experience as essentially being that we should look to the marketplace as our virtually total standard of conduct in our relations with the Third World.

Your comment that there were no particular new lessons to be learned in the last decade, just the application of traditional lending practices.

Have I accurately summarized your remarks?

Dr. **Greenspan**. Yes. I perhaps went to some slight extreme, but I substantially support that statement.

Senator **Graham**. Well, my ideas on this are not fully formed and not fully informed either, but I am concerned about that, because it seems to me that that is a very fundamental issue of, how does the United States view its economic future, in the context of increasingly international relationships. I am a marketplace person, when you are dealing with domestic issues. I feel less secure when we are dealing across international boundaries.

As an example, I was disturbed in looking at the history of the experience of Brazil and Argentina over the last 10 years, that while in Brazil, the best evidence is that 85 percent plus of the lending that went to that country was for what I would call economically justifiable development projects, projects which over a period of time will contribute to the economic strength of that country, that in Argentina, the percentage might be a third or less with the balance going to projects that were of little or no sustaining value to the country, yet the same lending decisions oftentimes by the same institutions were being made for both countries. There did not seem to be, in that history of those two countries, a sensitivity to what was in the interest of the lending countries or what was in the U.S. interest. In fact, some suspicion that there was no particular necessity to exercise lending prudence if things reached crisis level that the U.S. Government would step in and not allow major private lenders to go under as a result of their Third World debt.

That historical scenario may or may not be an accurate one, but if has as a degree of truth to it, it raises concern whether we can look exclusively to marketplace standards of success or failure and draw no lessons from our recent experience, other than those that would be applicable to domestic financial relationship, in terms of what we have just been through.

Dr. **Greenspan**. Well, Senator, I would give it a slightly different spin. Remember that American banks were not the only banks involved in it. In fact, in certain areas we were rather minor players, and, truly, the foreign banks who did very extensive lending, couldn't count on the Federal Reserve or the United States bailing them out. I think there was a general view extant at that time that sovereign nations never default. And that view, I think, pretty much was pervasive throughout that period and was a major factor, I believe, in leading to the extraordinary expansion.

You may recall, just before the whole thing unraveled, the data suggest that bank A didn't know that country X had just borrowed from Bank B, and at the very tail end, there was an awful lot of multiple borrowing, as the situation began to erode, and we ended up with much higher numbers as far as aggregate debt was concerned, than people, say, 6 months earlier, would have even remotely suggested was out there.

In other words, all the credit lines were all taken down simultaneously. And as a consequence of that, I think we ran into some very serious problems. I would doubt at that time, that there was any view of the American Government or the Federal Reserve stepping in and bailing out the system.

Senator **Graham**. So you would explain what, from a layman's point of view would seem to be a perverse lending policy, a level of those lenders' legitimate confidence in the sovereign nations' commitment to repay——

Dr. **Greenspan**. I'm not saying it was legitimate; I am just saying it was there. I'm not saying it was legitimate. Obviously, it wasn't, in retrospect, Senator. It was a terrible mistake.

Senator **Graham**. And from that experience, you would not draw any lessons of what change in policy, either by the Federal Reserve, the Congress, the institutions themselves should be implemented, other than to be more prudent in their lending policies?

Dr. **Greenspan**. I think that you are going to find that international lending will be significantly more prudent in the years ahead. I don't think any new policies have to be implemented. Stark realities of this particular episode have affected both debtor and creditor, and that is frankly one of the reasons why I am somewhat optimistic about the outlook.

There is a general awareness that the way the game was played prior to 1982 was neither advantageous to the commercial banking system nor to the debtor nations. And both parties are beginning to recognize that there is a mutuality of interests out there in which prudent lending serves a mutually advantageous purpose.

Senator **Graham**. If I could just conclude with a question.

Would you, therefore, take the position as Chairman of the Federal Reserve Board that if, in fact, there had been this expectation that the United States would bail out major domestic financial institutions, if they're lending to Third World countries proved to be so imprudent that it threatened their financial viability, that you would recommend a hands-off governmental policy?

Dr. **Greenspan**. Senator, that is the type of question which is actually similar to Senator Wirth's question, where the specific circumstances of those types of incidents are usually so different, one from the other, that I really cannot honestly tell you what the appropriate response would be, and I must tell you, I don't know, unless and until you actually see all the ramifications of various sets of policies, I don't see how one can realistically make a judgment. When that judgment is ultimately made, it is of necessity one based on some degrees of uncertainty, and I couldn't give you an example which I would feel sufficiently comfortable with, which I would be willing to answer in a hypothetical vein.

Senator **Graham**. If I could just comment, it seems to me that that answer gives heart to those who believe that they don't have to be very prudent in their lending policies, because in the final analysis, the Government is not going to allow these institutions to fail because of their imprudence.

Dr. **Greenspan**. I wouldn't read that into my remarks at all, Senator. What I am trying to convey is a nonanswer. [Laughter.]

The **Chairman**. Thank you, Senator Graham. Senator Sasser.

Senator **Sasser**. Well, Mr. Chairman, Dr. Greenspan has been sitting here for almost 3 hours with no respite, so I am somewhat hesitant about asking questions, but I will ask one.

Dr. Greenspan, a number of economists, including a distinguished economist with whom I would guess you don't have many areas of agreement, John Kenneth Galbraith, have written lately of the parallels between the 1920, late—well, the decade of the 1920's and the 1980's. They refer to the takeover trend, the huge increases in corporate debt, and even the insider trading scandals that occurred on Wall Street. All of these are pointed to as indicators of the kind of excesses that helped precipitate the Great Depression.

I would ask you if you see any similarities between now and the time before the Great Depression and what, if anything, should the Fed do about that whole problem.

Dr. **Greenspan**. Senator, I will give you an unusual answer to that question. The answer is, yes, there are many similarities, if one uses odd analogies between now and the late 1920's, but what's more important is whether what existed in the late 1920's, of necessity, created what occurred in the early 1930's. We have had, or more exactly, economic historians have had great difficulty in understanding precisely what went wrong from, say, 1927 forward. You will find an awful lot of differences in opinion but no general consensus of what created the problem.

I am inclined, as a consequence, to assume that the chances that the 1930's would occur as a consequence of what existed in the 1920's, was one chance in twenty, an accidental event, the sequence of events which occurred with a very low probability. And the trouble with that is that one out of twenty does occur 5 percent of the time, and when it occurs, there is a sense that it's inevitable.

So while I say to you today that yes, there are, if one looks at economic data on stock prices, on debt, on a variety of other different types of measures, there are similarities. But I am not at all certain that that should, therefore, lead us to the conclusion that we are on the edge of a major decline, because I don't think we are. I think what we are seeing is an extraordinarily successful market adjustment to a lot of the problems we have, and unless we engage in policies which are really irresponsible, I see nothing even resembling that type of event occurring.

Senator **Sasser**. I am going to give back some of my time, Mr. Chairman.

The **Chairman**. Well, bless your heart! Thank you very much, Senator Sasser. You are a very generous man.

Senator Wirth is recognized.

Senator **Sasser**. Thank you.

Senator **Wirth**. Mr. Greenspan, we have an economic situation with the Japanese that appears to be fraying the tempers on both sides, and this is an enormously important relationship to us and to the Japanese, and clearly, you are going to be engaged in a lot of discussions related to that relationship, assuming that you are confirmed and become the head of the Federal Reserve.

With that as background, if you were meeting with the head of the Finance Ministry or with the head of the Japanese Government, what would you be recommending to them steps that the Japanese ought to be taking to defuse some of the tensions on either side.

Would you recommend, for example, that they take greater responsibility in Third World debt, that they assume a larger share of the defense burden, import more goods into their country, a combination of all the above, others?

What would be your set of recommendations?

Dr. **Greenspan**. Well, that's a very good list, Senator, I wouldn't try to pick and choose from that, but what is clear is that the Japanese have become extraordinarily major players in the world. They have a remarkably efficient economy. We may complain a great deal about some of their trade practices, but the one thing we can't avoid is looking at something which is very successful. With success comes responsibility, and I think they are seeking to do a number of things. What that particular menu is, I, frankly, don't know at this stage. I don't know whether the particular list that you mentioned is what I would feel comfortable with, necessarily, or they would feel comfortable with, but "some of the above," so to speak, I think, is appropriate.

Senator **Wirth**. Well, let me just—if you don't want to answer that at this particular point, I understand that, that's all right, but it is a very important relationship to us all, and you are clearly going to be a major player in that and going to have to be a major player on behalf of this country, and I would only pose this part of the question by urging you to really give that consideration, and I am sure that you are. And we want to get into a situation where we are not bashing one another, but rather figuring out a way in which we can accommodate the interests on both sides, there is a synergism, it would seem to me, in that accommodation rather than pursuing the sort of confrontation that we seem to touch upon from time to time.

Dr. **Greenspan**. I certainly agree with that, Senator. I think that, owing to the nature of our two economies, we are going to have to live side by side for many, many years in the future as partners in a very extraordinary world.

Senator **Wirth**. Let me ask you, if I might, in the few minutes—seconds—remaining to me, ask you the reverse of Senator Graham's question, in which he was saying, should we be involved in any way, shape or form on the kind of loans that get made and the conditions of the loans that get made and expectations that the institutions have that we are going to back them up on the loan-making side.

The other side of that is the loan repayment side.

Should we continue to be pursuing the policies that the—say, the World Bank was pursuing and that we were, I think encouraging for a while, of very strict repayment schedules, in which there was very little, as I understand it, left in many of the debtor nations to invest in themselves after they were done repaying, servicing the loans to this country, or should we, as many of us suggested, pursue a more aggressive strategy of rescheduling that debt?

Dr. **Greenspan**. I think that the process which has evolved by trial and error in recent years, which includes all the players, the IMF, the World Bank, it is working and that that type of policy approach which we should continue with means, in a certain sense that there is no fixed, immediate agenda, but one seeks in each individual case to find the most appropriate solution which enhances the capability of restoring market access to these debtor conditions.

You know, it is not that long ago that there was considerable discussion that Brazil was on the edge of getting market access restored. This was the case as recently as August and September of last year, that they were in that trend, which is another way of saying that they are not all that far off nor are the other debtors. There is a way to go, but it is not an impossible task at all.

Remember that we are not endeavoring to get to a situation where these debts are paid off. What it is that you want to do is to get them into a serviceable position, where any individual holder of the debt can liquidate, in effect, sell to somebody else. Once you are in that position, then the system is working. That is what you want.

Senator **Wirth**. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Wirth.

When I finished my questioning, Dr. Greenspan, I was asking you about forecasts. You made a fascinating forecast on March 20. You said, "The recession we had not expected until 1990 now appears to be more likely to emerge in the last quarter of 1988 and in 1989."

Just in time for the next President of the United States to join the position of Herbert Hoover.

"The expected continued improvement"—this is Greenspan talking:

> The expected continued improvement in net exports and a stock market-led expansion of capital equipment in late 1987 is projected to lead to a final surge for the current business cycle. This surge is expected to precipitate a recession shortly thereafter rather than in early 1990 and a recession is also expected to be somewhat more severe than we have projected in October.

Do you stand by that still?

Dr. **Greenspan**. May I ask you what the date on that is?

The CHAIRMAN. The date was March 20, 1987. Four months ago.

Dr. GREENSPAN. I don't know how to answer that. Let me explain to you why. The economy is, at this stage, expanding, sluggishly. Capital investment is moving. Net exports are improving. But if you look at history, then we would expect that the economy would weaken at sometime out there—in other words, we know there is a recession out there. We don't know where it is. Whether it is late 1988, mid-1989, we don't know. At the moment, there are no evidences yet of a recession.

The CHAIRMAN. You were so specific in the dates in this forecast.

Dr. GREENSPAN. Yes. Now the reason we do that is that when you make a single forecast, the way clients use the information they cannot listen to the range is this and the range is that. They have to use a single number.

The CHAIRMAN. Right.

Dr. GREENSPAN. In the general context of making those forecasts, what we try to explain to them is what the probabilities are, and what we are trying to convey is that in front of us there is an expansion mode. Sometime later, and we don't know when, there is a contraction mode. And that is what we were trying to convey. I frankly don't know at this stage where the next downturn is. All I can tell you is that there is nothing visible on the horizon, but our horizon really is rarely more than a year and sometimes a good deal less than that.

The CHAIRMAN. I would like you to clarify what appears to be a contradiction in your position on the separation of banking and commerce, which is extremely important, I think, to Members of Congress and certainly, this Senator.

In your answer to Senator Wirth, you said you disagreed with the New York Federal Reserve President Corrigan on the need for separation of banking and commerce, but I thought you said earlier that you would not favor unrestricted ownership of banks, as long as banks enjoyed the Federal safety net. That is, deposit insurance, access to the payment system, discount window, and so forth.

Can you clarify that.

Dr. GREENSPAN. Yes. I thought I had made it clear, I am sorry if I hadn't, Senator. My view, basically, is this, that I don't believe it is desirable to have the implicit subsidy which a Federal deposit insurance guarantee grants to a bank, being used to finance a nonbank affiliate or it's——

The CHAIRMAN. That is exactly, precisely, what we do in the banking bill which passed the Senate, S. 790. We simply redefine a bank as an institution that has Federal deposit insurance. That is it.

Dr. GREENSPAN. Sure. And what I am saying, basically, is this, that if there is a mechanism, which I believe there is, which is essentially a so-called "fire wall" or "Chinese wall" by creating one of those regulatory barriers which prevents the commercial bank from being used by its nonbank owner to help finance itself. If that wall can be placed there, then I think that the threats to the banking system are essentially eliminated. If that wall cannot be constructed, and Jerry Corrigan thinks it cannot, then, if he is right, then I could not support commerce and banking under those conditions.

Since I believe that it is possible to do that, and I have talked to a number of people in the regulatory area who also believe that, I am inclined to think that it is something which should be explored very closely. But what I am not in favor of is an ability of a nonbank affiliate, buying a commercial bank and being able to use its deposit insurance and its access to the payments system and the discount window, because that, to me, is the use of a subsidy which would be wholly inappropriate in that context.

The CHAIRMAN. That makes your position very clear. Thank you. Senator Riegle.

Senator RIEGLE. There are two questions I want to raise. I want to keep this one as narrow as possible, and that is, your view as to what power the Fed has, as you see it, to grant banks additional powers without the express approval of the Congress.

Are there any, and if so, what would they be?

Dr. GREENSPAN. Well, that is an issue which I am not terribly knowledgeable on, Senator, but as I have said to you on other occasions, what I would like to see is far more specific guidance coming from the Congress.

Senator RIEGLE. We hope to do that. We have got a whole process set in motion to freeze the puzzle for a year to try to come up with a comprehensive answer, but absent that, there is great interest as to whether or not your view is that the Fed ought to become, in a sense, an active deregulator, expand bank powers, in the absence of action by the Congress, and I am wondering if, in fact, you support that view, and, if so, what powers you think banks could be given by the Fed without the approval of the Congress.

Dr. GREENSPAN. I have mixed feelings on that, Senator, because on the one hand, I would like to see banks have greater powers, because they need them, and I think it is important for the economy for them to have them.

On the other hand, I feel very uncomfortable in expanding what might be perceived to be the Federal Reserve's current posture with respect to discretionary types of grants of power, and so forth.

So that is the reason why I am very much desirous of seeing the Congress confirm matters with a new bill clarifying a number of these ambiguous issues and giving far greater guidance than is now available.

Senator RIEGLE. You know, on some recent votes on that very issue, Paul Volcker voted against some of the pending applications which the Fed approved. He was in the minority and took that view. So there has clearly been a split on the Board, and as a result, I think your views become very important, certainly, as the Chairman of the Board, in terms of the kind of direction you would like to see set.

Dr. GREENSPAN. Let me just say this, Senator. I don't know how I would vote in any specific cases, but I do know that the whole system would be significantly improved by a far more clarified set of guidances coming from the Congress.

Senator RIEGLE. Well, we agree on that, and we hope to do that. There is a serious effort under way in this committee, the chairman stated his intent. We have had hearings, we've got additional hearings planned, and we intend to try to do precisely that, that it really ought to be a legislative action, and we ought to work together on it and not end up sort of going off in separate directions.

I've gotten another chart here, since our last discussion a few moments ago, that shows what I think is a startling change in terms of our—change in status from a creditor nation to a debtor nation. And you gave Senator Shelby sort of a complex, comprehensive answer to the question, the dollar claims outstanding, and so forth, but if you just look at the last 4 years, the change in position from, roughly, 1982 to 1986, I find to be a breathtaking change in circumstance, particularly given the fact that we were a creditor nation in the blue area, uninterrupted, all the way back to 1914. So clearly, something profound, a series of profound things have happened in the last 4 years to create this change in circumstance. And I just give you that, because, coming back to that trade data for this year so far, we are holding at roughly the $170 billion annualized trade deficit level, so we are continuing to add new international debt at roughly the rate of $1 billion every 2½ days.

So we are continuing to ride that curve on into 1987. I have not updated this chart through the first 5 months, but the earlier chart would indicate that.

My concern is that I don't think we can continue that. Maybe I am wrong. We are in uncharted waters. We don't have any historic experience that we can compare this situation to, but when the New York Federal Reserve Board is estimating that we will owe the rest of the world something on the order of $1 trillion net within a period of 2½ years or so, that just seems to me to be such an extraordinarily adverse condition that I don't want to find out what it means, and I think we ought to find a way to get off that course, but that is the course we are on.

My real question to you is this: as a premier economic forecaster, as you look up that curve, if we stay on that curve, and we run up a $1 trillion international debt, what are the implications of that? Can we take it in stride? Is that something we need to really become alarmed about now? You know, your point earlier is, stop a recession before it starts. It seems to me, if that is where we are headed, now is the time to focus a discussion as to what we should—you know, is a condition that is dangerous to us, and do we have to get off this track?

Dr. GREENSPAN. The greater the external liability is denominated in dollars of the United States, the greater the number of problems that occur when holders of those dollars decide they want to switch in and out of them, and that will affect our domestic monetary policy accordingly.

The only thing I would say, as I said earlier, Senator, is that, even though that is $1 trillion, and that is scarcely petty cash, it is added to a base which, depending on how one defines the numbers, is at least twice that, and while it is a very substantial expansion in the aggregate proportion of dollar-denominated assets relative to assets denominated in other currencies, it at least is not of the order of magnitude of the type of problem which you describe.

In other words, what I am basically saying is, that, as far as the financial aspects are concerned, it is not crucially different where the dollars are originating from.

The issue here is, to what extent are those claims against us in direct investments, Government securities, private securities, because it is in that context that we are going to begin to see foreign ownership, foreign interaction with American ownership, and it is one of the reasons why we are now and have been, in a sense, entering the international arena, in a way which we have not previously.

Senator RIEGLE. My time is up, and I will come back after Senator Proxmire finishes, because I want to nail down with you, the point, the implication for monetary policy, because it seems to me this is a prescription for higher interest rates, and you are not saying that, and I don't know whether you are sidestepping it, or you just don't want to get into it, but I've got to ask you to address that issue, and I will come back in a minute and do that.

The CHAIRMAN. Dr. Greenspan, you wrote a chapter in Ayn Rand's book, "Capitalism: The Unknown Ideal," in which you spelled our your philosophical objections to the antitrust laws.

As Chairman of the Federal Reserve Board, you will be called upon to administer the Bank Holding Company Act. That act requires the Board to disapprove any bank merger that would result in a monopoly of banking in any part of the United States. It also requires the Board to reject mergers that would substantially lessen competition, unless the anticompetitive effects are clearly outweighed by the convenience and needs of the public.

Now those criteria are taken directly from the antitrust laws.

Given your philosophical objections to the antitrust laws, could you, as Federal Reserve Chairman, faithfully and objectively administer the antitrust provisions of the Bank Holding Company Act?

Dr. GREENSPAN. Yes, Senator. Abiding by the laws of the land, to me, is crucially important, and when I take an oath of office—should the Senate confirm me—it is far more important that those laws be adhered to, as far as I am concerned, rather than my personal preferences as to whether they are right or wrong.

The CHAIRMAN. Now let me see if I can ask you a specific case. I know that you don't want to make a judgment in a particular case, so let me put it this way.

Could you conceivably consider the merger of the two top banks in the country, in size. Supposing the Bank of America and Citicorp wanted to merge, would you look with favor on such a merger if it came before the Board? Would you consider it anticompetitive, automatically, or are there circumstances in which you could possibly approve it?

Dr. GREENSPAN. Senator, I——

The CHAIRMAN. Again, I am not asking you that particular case, but I am saying, is it conceivable that you could do this? Would you look at it with the notion of, well, maybe?

Dr. GREENSPAN. I would look at it to see what the full implications were in the context of the law. My own view is that, leaving aside the problems of unhealthy banks being absorbed by healthy banks, that the merger of two banks of that size makes no sense to me at all, economically. Why they would want to do it, I find another issue. But if you are asking me, would I be able to apply the law in that case, I am, as you point out, philosophically opposed to the Sherman Act. I have been and continue to be, but I understand it, and I understand the legal criteria which are involved in applying it and, hopefully, I am able to separate my own personal views from what is legally required.

The CHAIRMAN. That is both very discomforting and very comforting, if you know what I mean. [Laughter.]

Let me ask you this. There has been a great debate over the appropriate targets for monetary policy.

Some say we should stick with the monetary aggregates, such as M1, M2, M3. Some say the Fed should target interest rates. Others say the Fed should target the exchange value of the dollar or a basket of commodity prices. Still others call for targeting nominal GNP.

What are your own views on the appropriate targets for monetary policy? What should the Fed consider as its primary target?

Dr. GREENSPAN. I think you have to take a step back. I think what we have to first ask ourselves is, what is the Fed trying to do? And what the Fed is trying to do is to set an environment in which steady long-term maximum economic growth is feasible in our economy.

The CHAIRMAN. That is the primary——

Dr. GREENSPAN. That is the primary goal. And in doing that, as I said earlier, what we need to be very careful about is not to allow the inflation genie to get out of the bottle, because that will clearly undercut that goal. I believe, as I think most people still believe, that money does matter, that at least a significant aspect of Federal Reserve targeting has to be the monetary aggregates or something related to them.

That is not to say that one should not also be looking at the presumed effects on the economy of policies with respect to interest rates, prices, and GNP. Obviously, one looks at all of that, because it is very obvious that the simple rule on money supply doesn't actually work as often as we would like. And therefore, there have got to be different sorts of adjustments, but the basic problem that monetary theory has at this particular point is that we are developing, at the moment, I would say, a construction of what makes the economy work, which we are continuously changing.

We used to believe we knew exactly how the system worked, and we were wrong. Back in the 1960's, there was a belief that econometric models had captured what the system did. We now find that the system is changing in such an extraordinary way that what is required is to endeavor to evaluate what is currently going on and try to understand the abstraction which is driving it, and that, if we do understand it, will tell us what its policy should be.

And in that sense, I would say all of the items you mentioned are relevant issues in determining what policy should be, the weighting that you give to all those changes periodically, and I would argue further that, at root, you cannot get around the question of the monetary base, the various M's, as being crucial, irrespective of what one does with the rest.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Dr. Greenspan, I want to come back to this question of the problem here with this build up of international debt.

About 2 months ago, you recall, there was a major Treasury financing, and there was a rumor out, to the effect, that maybe the Japanese would not participate and come in and take down the amount that was normally expected that they would, and interest rates kicked up. It surprised a lot of people, and the prime rate has since gone up and adjustable rate mortgages have gone up, and a lot of bond traders took a giant bath, as you know, in the first quarter, and they are still reporting those losses, but I am told it is on the order of $10 billion. It is a large number in the aggregate, not that's——

Dr. **Greenspan**. I think most of it was in April.

Senator **Riegle**. Pardon?

Dr. **Greenspan**. April, not the first quarter.

Senator **Riegle**. Yes. You are right about that.

In any event, it struck me, and I think it struck many people of what Paul Volcker's talked about in major speeches himself, and that is, the more we become hooked on foreign lending, as we clearly are, the more volatility there is, if foreigners decide either to come in or not come in to a certain degree, and all of a sudden we start to see an up and down effect on interest rates here, and now you are about to take on the interest rate job, not that you control it directly, but you certainly are going to have the major role in it.

What I am concerned about is, it seems inescapable in my mind that when I see these kinds of trend lines, and I see us continuing to borrow this foreign money every single day, every single hour of every single day, become larger and larger net borrowers, that we are putting ourselves in a situation here that any time they want to interrupt that credit flow, it is going to cause repercussions in our credit markets. We have just seen it once. I mean, it doesn't seem to me that it takes a real leap to imagine that we are now in a new kind of relationship.

And my question to you is, first of all, I want to know if you see it this way, and if so, if your sense for it is that we are going to find ourselves put in a posture where our interest rates may start to take on more volatility simply because foreign lenders we now depend so much on, may decide, at a certain point, for whatever the reasons, that they don't want to lend us as much as we may want at that point. It just seems to me, prudence would dictate that we get off these curves, but I haven't really heard you say that yet.

Dr. **Greenspan**. Yes. Well, I will say it, if you want me to, because, clearly, it is a problem. I am concerned, however, that solutions that are advanced to resolve this problem can be worse than the disease, and what I am hoping that we are not moving towards, is some mechanism that endeavors to look at the numbers and say, well, it is a simple solution. All we have to do is shut down the deficit.

Senator **Riegle**. I don't think anyone's implied that, and I am not even sure we quite know the full range of what the solution ought to be. There is a debate, something of a debate going on about that, but for the moment, I want to just ask you to talk about the seriousness of the problem, before we get to the issue of a solution. And I am still not quite sure how sanguine you are about it, or the degree to which you feel that this is really becoming a major inhibiter or risk factor that is going to hem the Fed in, hem in our country in terms of our economic policy initiatives, because of what is building up out there.

Dr. **Greenspan**. Senator, let me broaden the issue. I would say that all countries' economic policies, both central bank and fiscal policies, are becoming ever-increasingly intertwined with everybody else's.

Senator **Riegle**. Yes, but nobody is running up these huge debts the way we are.

Dr. **Greenspan**. That is certainly the case. Nonetheless, that is an international phenomenon and one of the reasons, I might add, why international cooperation becomes increasingly valuable in this context. It is certainly also the case that we being the reserve currency are subject to more potential instabilities than the others, as we have seen and as you have evidenced.

This suggest to me that, not only do we have to be concerned about this, but a number of things. One of the reasons why I am very interested in thinking about this question of increasing capital, not only in the financial area, but nonfinancial, is that one way in which you can insulate yourself from instability is to have a higher degree of capital-to-debt ratio rather than the other way around.

And as a consequence of that, I think that there is more of a broad philosophy about what policy should be that is staring at us from that chart, than any specific action.

What the chart, in effect, is saying, and similar charts which we have seen on numerous occasions, is that the world is changing, and it is becoming increasing integrated, and we are increasingly involved, especially with the extraordinary increase in telecommunications, in a globalized environment. And it does suggest different types of policies, not dramatically different, but it does suggest that we have to recognize that the world is changing, and we have to adjust, where feasible.

Senator **Riegle**. Well, my time is up. I think this debt binge, this international debt binge is a clear and present danger, and we may differ on that, and I think if we let it run on for several more months or 2 or 3 more years, we are going to find ourselves caught in a series of events that we are not going to have much influence over, and I think it is dangerous if we allow that to happen.

The **Chairman**. About a dozen years or so ago, Dr. Greenspan, I pushed hard for requiring the Federal Reserve Board to come up with goals on monetary aggregates. And over the objections of—first, the objections of Chairman Burns, we finally put that into the law and the Fed responded.

Now what I had in mind, and I was the author of the bill, was that they would provide us with M1.

Dr. Burns said, we will not only give you M1, we will give you M2 and M3.

Now the present Chairman of the Board, there is one thing in which I strongly disagree with him, the present Chairman of the Board said we will give you M2 and M3, but not M1. We don't want to give you that anymore.

So we asked him to consult with the lawyer for the Fed, and the lawyer for the Fed said we have a legal right, because all the law says is that monetary aggregates, and that is the way we define monetary aggregates. We don't want M1 to be included.

As Chairman of the Fed, what would be your position on providing the Congress with your goals for M1?

Dr. GREENSPAN. The problem, Senator, is that at the moment, we don't know what M1 is.

The CHAIRMAN. Well, currency and the——

Dr. GREENSPAN. I am being slightly facetious.

Let me tell you what I think.

The CHAIRMAN. That should be easy to measure.

Dr. GREENSPAN. Well, yes. Let me tell you what the problem is. M1 was always meant to be some measure of transaction balances—as you remember, years ago, it was demand deposits plus currency, and we decided that that was sort of a proxy for what transaction balances were. And then the world changed. First, a lot of our currency is obviously abroad or doing other things unrelated to transaction balances, and we began to get negotiable orders of withdrawal and a number of other elements which had quasi-transaction characteristics which weren't clear.

I don't think the concept of transaction balances has changed, that is, that that is a relevant consideration to try to control, but it is not clear what numbers really are best reflected in it. I suspect, Senator, that what we are going to end up with at some point, is a redefinition of what constitutes those transactions and, hopefully, the Fed will be able to respond again and give you guidelines, but until there is some general satisfaction that, in a sense, the Federal Reserve is measuring transaction balances, rather than something else, I am not certain what, in effect, is the use of guidelines or any particular——

The CHAIRMAN. What is wrong with letting us know? Just giving us what your goals are, but then hedging them any way you want. I mean, tell us that you don't think that this is very—that M2 and M3 is more useful, and so forth.

Dr. GREENSPAN. Yes. Mr. Chairman, I am arguing from a large lack of knowledge about specifically why staff and the Board and the Open Market Committee have come to their views. I am just giving my own personal views which may or may not coincide with theirs.

My concern is that to give you targets on a number which is ambiguous probably will merely lead to the conclusion that the Federal Reserve will have targeted a number over which it really had no insight and could be extraordinarily off without any economic or monetary significance.

That is what I think the problem is. I think it is a lack of knowledge rather than any particular desire on the part of the Federal Reserve to rejuggle the game.

The CHAIRMAN. I have a question that I am going to ask for the record, that I hope that you can respond to in writing, on the loan loss reserves recently taken by the banks, especially National City Bank. But I won't ask you about that.

I would like to conclude, Dr. Greenspan, by saying, this is an extraordinary kind of a situation. I think you are a remarkable man. You are going to be overwhelmingly approved. I may vote against you. But this nomination should result in a slam-bang debate in committee and on the floor. It won't. And it is startling, in view of what you have told us.

Your forecasting record, as I pointed out, has not been good. It's been bad. You are opposed to the antitrust laws of this country, but you will carry out the laws, although you oppose them.

We didn't get into your position on direct investment by savings and loan associations, but many of us feel that that direct investment can mean the downfall of an industry that provides financing for our home buying.

Your position on banking and commerce, again, is that you would obey the law, as I understand it, but you think, if you erected Chinese walls, you can still merge banking and commerce. And that shocks this Senator, and I think it should shock many others.

You, in my judgment, favor an increased concentration of banking, if that is the way the economy seems to be moving.

And you will move in with a Board of clones—not clowns, clones. You will find that the people you are working with are people who agree with you pretty much. They have all been appointed by President Reagan. They share, to more or less of an extent, the views you have.

This is not a diversified Board. It is the most homogeneous Board we have ever had, all on one side.

It seems to me that banking in this country and finance in this country is moving very sharply, likely to move very sharply in the next 4 or 5 years or more perhaps in the direction of concentration and in a direction which, I think, most Senators, if they thought very long about it, might be very concerned about it. And I think the American people would be too.

Nevertheless, you are a very good man. We are going to act on your confirmation swiftly, and as I say, I expect that it will be overwhelmingly approved, although there may be one or two dissenters.

Thank you very much.

Dr. **Greenspan**. Thank you, Mr. Chairman.

[Whereupon, at 1:35 p.m., the hearing was adjourned.]

[Response to written questions and biographical sketch of nominee follow:]

Mr. Greenspan subsequently submitted the following in response to written questions from Chairman Proxmire in connection with his nomination hearing on July 21, 1987:

Question 1: There are some who argue the Federal Reserve should play a far more active role in managing the value of the dollar as measured against foreign currencies. According to this view, the FED should step in to prevent the dollar from rising too high or falling too low from its natural level.

On the other hand, the Milton Friedman school of economics argues that there is no way policymakers can divine the appropriate level of the dollar and that the level ought to be set by market forces without any governmental intervention.

How do you come down on this issue?

Answer: There are times when intervention in exchange markets can be a useful adjunct to other policies, but intervention per se, without accompanying changes in underlying policies, cannot and should not be relied upon to have large or lasting impacts on exchange rates. Moreover, it is, indeed, difficult to know what the appropriate exchange rates should be at any time; indeed, they may well change over time.

The best, and really only, way to achieve reasonably stable exchange rates over the medium term is to get fundamental monetary and fiscal policy settings right, here and abroad.

Question 2: In the past, you have suggested a return to the gold standard. What are your current views on this issue? If you are confirmed as Federal Reserve Chairman, will you make a return to the gold standard a top priority?

Answer: Under the conditions of the nineteenth century the gold standard probably worked more effectively than critics assert today, and if the key conditions could be replicated we might be well served by such a standard. However, considering the huge block of currently outstanding dollar claims in world markets, fixing the price of gold by central bank intervention seems out of reach.

Question 3: As you know, many of our major banks have recently begun to set aside loan loss reserves against their loans to the heavily indebted developing nations. Mr. John Reed, the Citicorp Chairman, in announcing Citicorp's decision to do that said "looking at world economic conditions Citicorp's management decided it may not be able to collect all of the $14 billion it has lent to financially troubled Third World countries, especially those in Latin America. The $3 billion placed in reserves is only a very rough estimate of the potential loss on that $14 billion."

So the banks are finally admitting they may take major losses on these loans. The only problem is the new loan loss reserves do not result in any capital increase by the banks. They are only moving capital from one pocket to another. Their overall safety is not improved by these reserves.

There is a debate now taking place on whether to include loan loss reserves in a bank's capital or whether to exclude them as I understand the British bank regulators do. What is your view on this matter?

Answer: My understanding is that the question of loan loss reserves is indeed one the issues currently under discussion among banking regulators seeking to harmonize the capital adequacy standards. I believe that this effort is of critical importance, if we are to achieve both greater safety and soundness of our banking system while ensuring a reasonably even playing field for our banks as they compete in the international marketplace. I certainly shall be devoting a good deal of personal attention to the matter, should the Senate confirm me as Chairman of the Board of Governors, but at this point I hope you will understand my hesitance to risk a possible complication of the negotiations on this key issue by voicing a viewpoint before I have had the opportunity to discuss it fully with the other parties.

Question 4: As you know, there has been a stalemate on Capitol Hill on the issue of bank deregulation as it affects the products and services that banks can offer either directly or through affiliates. Some have suggested that if Congress does not pass a comprehensive banking bill the bank regulators should take the initiative.

What is your general attitude on this question? Do you believe in stretching the current law to its outer limits if the Congress does not act in a timely fashion?

Answer: There is no satisfactory substitute for timely and definitive action by the Congress on the broad issues of financial institution powers.

"Stretching the current law to its outer limits" is a distinctly inferior approach, for the regulatory authorities can not implement major structural change within the present legal structure that results in equitable treatment for all participants and a sound, stable financial system.. The regulatory agencies must, of course, carry out the law as it exists, and I would do that to the best of my ability.

Question 5: Mr. Greenspan, public commentators have been offering you a great deal of free advice since you were nominated. Let me quote from Paul Craig Roberts. I find him especially interesting since he is one of the gurus of Reaganomics in this administration, which appointed you. I quote: "The budget deficits of the 1980s are the result of the unexpected collapse of inflation. . . . Whenever inflation falls below the forecast, it means the government has, in effect, over-budgeted for inflation--collecting less revenue than planned and spending more in real inflation adjusted dollars than intended. The deficit far from being a source of inflation is a result of more disinflation than expected." What do you think of this advice?

Answer: I think that this analysis involves some debatable conjectures on what might have been. But, more importantly, I'm concerned that it may distract from the current problem we face. The fact is that the budget deficit is too big for an economy that produces as little saving as we do and that is depending so heavily on a masive inflow of capital from abroad. We need to reduce that deficit, and to my mind the best way do go about that is to reduce federal spending, which is running at an historically high rate relative to gross national product.

Question 6: As you know, the Federal Reserve is a collegial body. Members of the Board or the Federal Open Market Committee can and often do dissent from the decisious of the majority. As you look back on the conduct of monetary policy over the last ten years, what are the one or two major issues over which you would have dissented from the actions taken by a majority of the FED?

Answer: The decisions faced by the FOMC tend to involve more matters of judgment about the trend of the economy and the appropriate settings for the instruments of monetary policy rather than what might be regarded as discrete, major issues. Such judgments always must be made with incomplete information, and I'm sure that with the benefit of hindsight the FOMC members might now acknowledge that they did not make precisely the right decision in every case. There have been times when my sense of the strength of the economy and the intensity of inflationary pressures has differed from the apparent majority view of the FOMC, but I can't say that any instances of great consequence come readily to mind of decisions that appeared wholly inappropriate, given the available facts. Indeed, what comes to mind more quickly is the fact that on the pivotal decision on the direction of policy in the past decades, namely, the decision to act very forcefully in the early 1980s to stem the escalating inflation, I was supportive of the FOMC and felt that it was a step that had to be taken despite the painful short-run economic fallout.

Question 7: I know you are not being nominated to regulate the thrift industry, but I am troubled by a comment you made before a House Government Operations subcommittee. I quote: "The industry simply cannot overcome the structural problems that threaten it if its associations are restricted generally and the types of investments that they are permitted to make are limited." Does this mean there is no place for the traditional home-mortgage maker?

Answer: Clearly, the home mortgage market has changed enormously over the past decade or so. The key to this change has been the development of the mortgage-backed security, which has made it possible to tap a broad range of ultimate providers of capital and permitted institutions to act as originators and servicers without also being holders of loans. Many thrift institutions have in fact chosen to become to a considerable degree mortgage bankers, packaging loans they originate for "securitization" and retaining servicing.

While some institutions continue to be important portfolio lenders, in a sense along the traditional lines I think you have in mind, their ability to do so safely and successfully has to an extent depended on their ability to utilize adjustable rate loans and to hedge interest-rate risks through proper liability management. However, it is not clear that, with current asset powers, they have the means at their disposal, to hedge adequately the interest-rate risks that are present in all but the most stable, noninflationary economic environments. Consequently, these institutions can benefit from the ability to diversify their loans and investments into areas in which maturities are shorter or interest rates more flexible. Moreover, diversification geographically and among categories of investment also can help institutions control credit risks exposure. My view is that thrifts should be afforded the freedom to diversify in those ways, but that—insofar as they choose to go that route and thus become more like commercial banks or other intermediaries--they also must be subjected to similar treatment with respect to supervision, regulation, and access to federal subsidy or support systems.

Mr. Greenspan subsequently submitted the following in response to written questions from Senator Riegle in connection with his nomination hearing on July 21, 1987:

Question 1:

Considerable attention has been paid to the relatively high cost of labor in the United States and that is often given as the excuse for the imbalance in our international trade. But comparatively little attention is paid to our high cost of capital and the impact of such capital costs on the competitiveness of American industry. It seems to me that if the average cost of capital to a major Japanese enterprise is around 2.5 percent (as it is) and the average capital costs to a comparable American enterprise is about three times that figure--that the competitive advantage of Japan over the United States is formidable, particularly in capital intensive industries such as steel, auto, electronics and chemicals. Do you think that capital costs are more, less or about as important as labor costs in the competitiveness of American industry? Do you think that the cost of capital to American business is higher, lower or about the same as the cost of capital to our major foreign competitors? Do capital costs affect the international competitiveness of American industry? What policies do you think the Federal Reserve should follow to enhance the competitiveness of American industry?

Answer:

Capital costs in the United States and abroad clearly are an important element in determining the competitiveness of American products in world markets, but they are only one factor among many. In both the United States and Japan, labor costs are significantly more than half the cost of total inputs, on average, while capital costs are substantially less than one-half. Across individual industries, however, the share of different inputs varies, and capital costs can be of greater importance for those products.

Measurement of the real cost of capital can be difficult, and studies by different analysts have obtained somewhat different results. Different rates of time preference, and high rates of saving in Japan, have contributed to lower real rates of interest in that country, which international capital flows have not completely equalized. However, the cost of capital depends not only on the cost of borrowing at market interest rates, but also on the details of the tax treatment of business income. This involves questions of depreciation procedures, possible government grants or other transfers to firms, tax rates, and tax incidence. It is also necessary to take account of the cost of financing new capital accumulation through equity as well as through borrowing.

The Federal Reserve can contribute to an improved competitive position for U.S. firms by creating favorable economic and financial market conditions. This means we should avoid the unnecessary uncertainty for U.S. business associated with high and variable inflation rates, with excessive volatility in exchange rates, and with the associated risk premia, which add to the cost of capital. However, other policies can influence the cost of capital. Perhaps most important is the role of Congress in influencing the total balance of savings and consumption, both public and private, in the United States.

Question 2:

According to a recent article in the New York Times, in the late 1970s when economists for the most part were predicting higher energy prices for the better part of the century, you believed that prices would level off or fall--and you were of course correct. Energy prices are extremely important to the outlook for inflation. What are your views regarding the direction of energy over the next five to ten years?

Answer:

Forecasting energy prices is a difficult business for an economist, especially over a five to ten year horizon. The market for oil obviously is crucial to the outlook for energy prices more broadly, and oil prices over the past decade have been dominated by political, or at least not purely economic, factors.

However, barring any major disruptions to oil supplies, I would expect the real price of energy to be higher five to ten years from now. Energy demand should rise, in line with generally rising economic activity. Energy supply may rise somewhat also, but at current prices exploration and development of new sources of supply are not likely to be strong enough to prevent increasing demand for OPEC oil. Excess supply still persists in the Middle East, however, and this should temper any strong tendency for prices to rise--again barring major political disruptions.

Question 3:

What do you think are the biggest management problems facing the Federal Reserve Board and what solutions would you bring to those problems? What recommendations would you make to enhance Congressional oversight of the Fed?

Answer:

I should perhaps not offer any very specific comments on "problems" until I have had the opportunity to view the workings of the Federal Reserve from the inside. My sense is that this is a generally well run organization, with a clear recognition--reflected in the efforts toward cost restraint and productivity enhancement described in various public reports--of the need to husband carefully the public's resources. I certainly want to ensure that that is, and continues to be, the case.

The question of Congressional oversight over the management and budgets of the Federal Reserve has arisen many times through the years, and my belief is that, in light of the internal controls that exist and the amount of information that is provided, the decisions taken not to alter the relationship between the Federal Reserve and the Congress in this sphere have been appropriate and consistent with the preservation of necessary independence of action on the part of the central bank.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: GREENSPAN (LAST) Alan (FIRST) (none) (OTHER)

Position to which nominated: Chairman, Board of Governors of the Federal Reserve System

Date of nomination:

Date of birth: 6 (DAY) 3 (MONTH) 26 (YEAR)

Place of birth: New York, N.Y.

Marital status: Single

Full name of spouse: (none)

Name and ages of children: (none)

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Geo. Washington H.S.	1940-43	Diploma	
New York, N.Y.			
New York University	1945-48	B.S.	1948
New York University	1948-50	M.A.	1950
New York University		Ph.D.	1977

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Colgate University, Hamilton, NY Ph.D. (honorary)

Hofstra University, Hempstead, NY Ph.D. (honorary)

Pace University, New York, NY Ph.D. (honorary)

Thomas Jefferson Award for Greatest Public Service Performed by an Elected or Appointed Official, given by the American Institute for Public Service

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
(See page S1, S2 attached.)		

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Research Associate -- National Industrial Conference
Board, New York, N.Y. 1948-1953
Economic Consultant -- Townsend-Greenspan & Co., Inc.
New York, N.Y. 1953-1977, 1977-present
President and Chairman: 1954-1977; 1977-June 1987
Chairman: June 1987-present
Chairman -- Council of Economic Advisers, Washington, D.C.
1974-1977

Government experience:

List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

1981-83 Chairman, National Commission on Social Security Reform

1981-present Member, President Reagan's Economic Policy Advisory Board

1983-85 Member, President's Foreign Intelligence Advisory Board

(For additional, see page S-3 attached.)

Published writings:

List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Enclosed are representative articles since 1980.

(For list, see page S-3 attached.)

Political affiliations and activities:

List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Reagan For President Committee, 1980

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

10/28/82	$1,000	Cissy Baker Committee
5/10/83	$1,000	People for Pete (Domenici) Comm.
6/ 8/83	$1,000	Salute to Senator Helms
6/23/83	$ 500	James S. Brady
10/19/83	$ 500	Cheney For Congress
5/ 7/86	$1,000	Bob Dole for Senator

(For additional, see page S-3 attached.)

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

(See page S-4 attached.)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

No

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

Deferred compensation agreements with the following corporate boards: Aluminum Company of America; Automatic Data Processing, Inc.

(For additional, see page S-4 attached.)

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

(See attached copy of letter in response to query by Chairman Proxmire.)

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

(See attached copy of letter in response to query by Chairman Proxmire.)

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I plan to sever all previous relationships and recuse myself if at any time the interests of past business associates or clients are directly involved.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

Memberships:

Organization	Office held (if any)	Dates
Townsend-Greenspan & Co., Inc.	Chairman & President	1954-1974 1977-present
AG Ventures	Board of Directors	11/1/85-1/31/87
Greenspan O'Neil Associates	Chairman, Investment Policy Committee	11/1/85-1/31/87
Aluminum Company of America	Board of Directors	4/20/78-present
Automatic Data Processing, Inc.	Board of Directors	8/22/80-present
Capital Cities/ABC, Inc.	Board of Directors (ABC) (CC/ABC)	5/15/84-1/3/86 1/3/86-present
Mobil Corporation	Board of Directors	9/23/77-present
Morgan Guaranty Trust Company of New York	Board of Directors	7/6/77-present
J.P. Morgan & Co., Incorporated	Board of Directors	7/6/77-present
The Pittston Company	Board of Directors	5/15/85-present
General Foods Corporation	Board of Directors	1977-1985
The Rand Corporation	Board of Trustees	6/86-present
Gerald R. Ford Foundation	Board of Trustees	1981-present
The Economic Club of New York	Vice Chairman, Board of Trustees	9/84-present
Council on Foreign Relations	Board of Directors	1982-present
Committee For a Responsible Federal Budget	Director	6/10/81-present
Institute For International Economics	Board of Directors	10/81-present
Hoover Institution	Board of Overseers	1973-1974 1977-present
The Ronald Reagan Presidential Foundation	Board of Governors	1986-present
The Trilateral Commission	Member, Executive Committee	7/21/82-present
Time Inc.	Board of Economists	1971-1974 1977-present

Century Country Club Purchase, NY	Member	3/30/79-present
Hillcrest Country Club Los Angeles, CA	Member	12/75-present
City Mid-day Club New York, NY	Member	12/83-present
Harmonie Club of The City of New York	Member	1971-present
The University Club New York, NY	Member	3/79-present
Conference of Business Economists	Member, Past Chairman	1963-present 1974
National Association of Business Economists	Member, Fellow, Past President	Early '60s-presen 1969-1970
National Economists Club Washington, D.C.	Member, Past Director	4/69-present
Brookings Panel on Economic Activity Washington, D.C.	Senior Adviser	1970-1974 1977-present

Qualifications:

I have been an economist for almost 40 years, first as an analyst, and in recent years as a consultant. My work has covered both industrial and financial sectors of the United States and, to an increasing extent, the rest of the world. I have considerable knowledge of American financial structure (I served on the President's Commission on Financial Structure and Regulation, 1971) and monetary theory. I have served on the boards of directors of a savings and loan holding company (Trans-World Financial, 1962-74) and a bank holding company (J.P. Morgan, 1977 to present). My service as Chairman of the Council of Economic Advisers (1974-1977) offered opportunities to broaden my experience beyond the private sector.

Potential
Conflicts
of Interest:

1. Capital Cities/ABC, Inc.; General Foods Corporation; Mobil Corporation; J.P. Morgan & Co., Incorporated; Morgan Guaranty Trust Company of New York; The Pittston Company

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ALAN GREENSPAN
120 WALL STREET
NEW YORK, N. Y. 10005

June 30, 1987

The Honorable William Proxmire
Chairman
U.S. Senate
Committee on Banking, Housing,
  and Urban Affairs
Washington, D.C.

Dear Mr. Chairman:

The following is in response to your letter of June 11th requesting information about certain client relationships.

For purposes of accounting, Townsend-Greenspan & Co. divides its various services into:

(1) general consulting, which reflects our forecasts and analyses of the economic outlook.

(2) Specifically designed client presentations on analytical subjects, such as facilities planning techniques, the long-term world demand for oil, etc.

(3) What we call "advocacy projects," which reflect any analysis or presentation that is directed, not at forecasting but, to the development of ideas, which lead to a particular point of view on company, industry, or public policy. We make it clear to potential clients for such services that these are our positions and they may or may not choose to publicize the results of our work. Some have chosen not to. These presentations generally reflect my personal views on specific policy questions, almost always as an extension of some analytical research. Much of the economic analysis in this segment of our business has been in support of my personal views on the necessity to protect intellectual property rights, and to further financial deregulation.

to assist their client, Lincoln Savings and Loan Association, in an evaluation of the desirability of broadened savings and loan direct investment powers. This resulted in a published study submitted to the Federal Home Loan Bank Board and was subsequently the basis of invited testimony before the Commerce, Consumer and Monetary Affairs Subcommittee of the House Committee on Government Operations (February 27, 1985).

Our total billing (including expenses) to Paul, Weiss, Rifkind, Wharton & Garrison, was:

1984 $
1985
1986
1987 ______
Total $

This project is now complete.

Sears Roebuck and Company is a regular general consulting client for whom we also consult on various aspects of financial structure and regulation. We have been asked to analyze and criticize a number of their proposed initiatives in the financial services area. I have also made a number of presentations on their behalf before various private associations and groups outlining my views on financial deregulation. Our total annual retainer from Sears has been $. It covers my personal time devoted to presentations and analyses, as well as the time of our staff.

If there is any additional information I can present, please let me know and I will endeavor to make it available.

Sincerely,

Alan Greenspan

AG:an

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

September 17, 1987

The Honorable William Proxmire
Chairman
Committee on Banking, Housing, and
  Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of August 12. I am pleased to enclose staff responses to your questions about the overseas securities activities of U.S. banks and bank holding companies.

I hope this information is useful to your Committee. Please let me know if we may be of further assistance.

Sincerely,

Enclosure

September 1987

Federal Reserve Staff Responses to Questions from Chairman Proxmire About the Overseas Securities Activities of U.S. Banks and Bank Holding Companies

(1) What types of securities are U.S. banking organizations underwriting, distributing, and dealing in abroad? Be as specific as possible, and be sure to state whether U.S. banking organizations are underwriting, distributing, and dealing in corporate debt and equity securities of U.S. issuers.

Response. U.S. banks may underwrite, distribute, and deal in government securities of their host authorities through their foreign branch offices. U.S. banks and bank holding companies may also conduct these activities for corporate debt and, to a limited extent, equity securities through separately incorporated foreign subsidiaries. These activities may relate to securities of U.S. issuers, but in no case may the securities that are underwritten by the U.S. bank affiliate be sold to investors in the United States. The Federal Reserve currently limits equity underwriting commitments of foreign subsidiaries of U.S. banking organizations to $2 million (or 20 percent of the capital and surplus or voting shares of the issuer) unless the underwriter is covered by binding commitments from subunderwriters or other purchasers.

(2) How many U.S. banking organizations engage in those activities abroad?

Response. U.S. banking organizations have general authority to conduct these activities abroad under the Board's Regulation K. Consequently, they do not need specific approval in order to engage in the activities and may commence or cease these activities without notice to the Federal Reserve. Therefore, a precise number of institutions engaged at any one time in these activities is not available. As a practical matter, however, approximately a dozen large U.S. banks have significant merchant or investment bank subsidiaries that conduct this business and account for the vast majority of all such activities conducted by U.S. banking organizations. A list of those banking organizations is provided in Table 1.

(3) What is the dollar volume of those overseas activities?

Response. The Federal Reserve does not collect or systematically compile statistics on the volume of underwriting or trading activity conducted by these offices, but other sources of general information are available. The March, 1987 issue of Euromoney, the British publication that covers these markets, ranked the 50 largest "bookrunners" in the eurobond market for 1986, which covered fixed rate securities, warrants for equity, convertibles, and floating rate notes.[1] That listing indicated that six U.S. banks accounted for $16.6 billion in eurobond underwritings, or about 10 percent of the total for the 50 most active institutions. Those banks, along with their corresponding volumes, are shown in Table 2.

(4) Have those activities been profitable?

Response. The merchant and investment bank subsidiaries that conduct these activities have been generally profitable in recent years. The Federal Reserve does not, however, collect information showing the profitability of specific activities. Since these subsidiaries conduct a broad range of activities and provide many services, it is not possible to estimate from the available aggregate data what portion of net earnings or losses can be attributed to securities underwriting and trading.

Partial information suggests that earnings from these activities are volatile and may have declined, especially with the increased level of competition in the London market. Some large banking institutions, such as Lloyds Bank and Midland Bank, have withdrawn from some segments of the securities markets in London because of the poor outlook for profits. Last spring several U.S.-owned merchant banks, along with other active market participants, incurred significant losses on their trading positions when interest rates suddenly rose. Underwriting losses were also realized in the floating rate note market.

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[1] Bookrunners generally coordinate the securities issues and perform a key role in the underwriting process by distributing shares to other managers and handling many of the administrative tasks.

(5) To what extent would those activities be conducted in the United States but for the Glass-Steagall Act?

Response. Many of these activities might be conducted in the United States if Glass-Steagall were not in effect. However, probably little of the *current* securities business conducted abroad by U.S. banks would be transferred to the United States, given the present nature of that business. The greatest effect would be that U.S. banks would compete actively for business from which they are currently banned.

(6) Have those activities jeopardized the safety and soundness of the banking organizations engaged in them? Have those activities given rise to abuses or other problems, such as the "subtle hazards" discussed by the Supreme Court in Investment Company Institute v. Camp, 401 U.S. 1091 (1971)?

Response. At present, no U.S. banking organization has incurred sufficient losses on its foreign securities underwriting or trading activities to threaten the safety of affiliated banks. The experience, however, is relatively short. As mentioned, U.S. banking organizations have limited opportunity to take positions in connection with underwriting or trading *equity* securities, and the eurodebt markets were relatively small until recent years.

We are also not aware of any material problems that have arisen from the "subtle hazards" associated with the mixture of banking and securities activities. The risks, however, as well as potential conflicts of interest, are a matter of concern. The subtle hazards could be defined to include damage to a bank's reputation arising from its securities business. In this connection, there have been instances where banks have covered losses of subunderwriters when issues were mispriced (in order to protect their reputations and to facilitate market entry) or have suffered undesirable publicity because of personal positions taken by traders on securities the bank was underwriting.

Subtle hazards may be prevented by clear rules to guide behavior, thorough internal controls, an emphasis on ethical conduct by employees, and active supervision by management and regulatory authorities. The Federal Reserve has communicated the importance of such procedures to its supervisory staff and, in turn, to the banking community and will continue to be alert to such conflicts.

Table 1. U.S. banking organizations with significant merchant or investment banking subsidiaries, 1986

BankAmerica Corporation, New York
Bankers Trust Company, New York
Chase Manhattan Corporation, New York
Chemical New York Corporation, New York
Citicorp, New York

Continental Illinois Corporation, Chicago
First Chicago Corporation, Chicago
First Interstate Bankcorp, Los Angeles
Manufacturers Hanover Corporation, New York
Morgan (J.P.) and Company, New York

NCNB Corporation, Charlotte
Republic NY Corporation, New York
Riggs National Corporation, Washington, D.C.
Security Pacific Corporation, Los Angeles

Table 2. U.S. banking organizations among the top 50 bookrunners for all issues of Eurobonds, 1986

Millions of dollars

Rank	Organization	Amount
4	Morgan Guaranty	$9,822
21	Bankers Trust	2,546
23	Chase Manhattan	2,124
40	Chemical Bank	734
41	Bank of America	700
42	Citicorp Group	697
	Total	$16,623

Source: Euromoney, March, 1987

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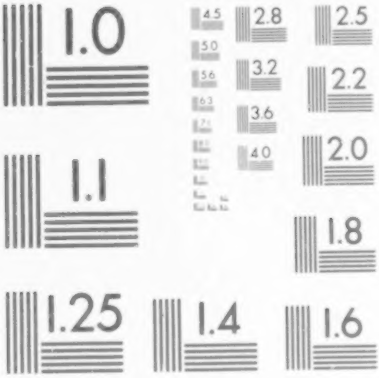
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4.5
5.0
5.6
6.3
7.1
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1.1
1.8
1.25
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1.6

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